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Economic Survey
Winter 2020

Economic Prospects

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Winter 2020

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Abstract

GDP is expected to contract by 3.3% in 2020, to be followed by 2.5% growth in 2021.

The forecast is based on the assumption that stringent restrictions will be imposed at the end of the year to press down the incidence rate of COVID-19 infections, which will retard economic growth. Domestic demand for services will remain weak and foreign trade suffers from the continued pandemic.

The economy is expected to recover when the uncertainty caused by the pandemic is dispelled in the course of 2021. Growth in demand items that will accelerate towards the end of 2021 will give an additional boost to the economy in 2022. GDP is expected to grow by 2.0% in 2022 and 1.4% in 2023.

The deficit in general government finances will remain substantial in 2021 as the healthcare efforts required to deal with the pandemic and the support measures to alleviate its effects keep public expenditure at a high level. The imbalance between revenue and expenditure will remain so large that public debt in relation to GDP appears to continue to grow throughout the first part of the 2020s.

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Tiivistelmä

Bruttokansantuotteen arvioidaan supistuvan 3,3 % v. 2020 ja sen jälkeen kasvavan 2,5 % v. 2021. Ennuste perustuu oletukselle, että covid-19-epidemiaan liittyvien tautitapausten ilmaantuvuus painetaan voimakkailla rajoituksilla matalalle tasolle vuoden vaihteen aikana, mikä hidastaa talouskasvua. Kotimaassa palveluiden kysyntä pysyy edelleen heikkona ja ulkomaankauppa kärsii pandemian jatkumisesta.

Talouden toipumien alkaa pandemian aiheuttaman epävarmuuden poistuessa vuoden 2021 kuluessa. Vuoden 2021 loppua kohden kiihtyvä kasvu nostaa myös vuoden 2022 talouskasvua. BKT:n arvioidaan kasvavan 2,0 % v. 2022 ja 1,4 % v. 2023.

Julkisen talouden alijäämä pysyy suurena v. 2021, kun vuoden alkupuolelle jatkuvan epidemian hoito ja sen vaikutuksia lieventävät tukitoimet pitävät julkiset menot korkealla tasolla.
Tulojen ja menojen välinen epätasapaino pysyy niin suurena, että julkinen velka suhteessa bruttokansantuotteeseen näyttää jatkavan kasvuaan koko 2020-luvun alkupuoliskon ajan.

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Sammanfattning

Bruttonationalprodukten uppskattas minska med 3,3 procent under 2020 och därefter öka med 2,5 procent 2021.

Prognosen baserar sig på antagandet att incidensen av sjukdomsfall som hänför sig till covid-19-epidemin pressas ned till en låg nivå kring årsskiftet till följd av de kraftiga restriktionerna, vilket dämpar den ekonomiska tillväxten. I Finland är efterfrågan på tjänster fortfarande svag och utrikeshandeln lider av den fortsatta pandemin.

Ekonomin börjar återhämta sig när den osäkerhet som pandemin orsakar börjar avta under 2021. Mot slutet av 2021 ökar den snabbare tillväxten av efterfrågeposter även den ekonomiska tillväxten 2022. BNP beräknas öka med 2,0 procent 2022 och med 1,4 procent 2023.

Underskottet i de offentliga finanserna är fortfarande stort 2021 i och med att hanteringen av epidemin fortsätter i början av året och de stödåtgärder som lindrar konsekvenserna av den håller de offentliga utgifterna på en hög nivå. Obalansen mellan inkomster och utgifter hålls på en så hög nivå att den offentliga sektorns skuld i förhållande till bruttonationalprodukten ser ut att fortsätta öka under hela första hälften av 2020-talet.

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SYMBOLS AND CONVENTIONS USED

-	nil
0	less than half the final digit shown
..	not available
.	not pertinent
**	forecast
CPB	CPB Netherlands Bureau for Economic Policy Analysis
HWWI	Hamburgisches WeltWirtschafts Institut
IMF	International Monetary Fund
MEAE	Ministry of Economic Affairs and Employment
MoF	Ministry of Finance
MSAH	Ministry of Social Affairs and Health

Each of the figures presented in the tables has been rounded separately.

ECONOMIC SURVEY WINTER 2020

This Economic Survey offers projections of economic developments in 2020–2023. In addition to short-term prospects, it includes a medium-term economic outlook extending to 2025.

The forecast and trend projections in the survey are prepared independently by the Ministry of Fi-nance Economics Department based on the Act on the implementation of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union and on multi-annual budgetary frameworks (869/2012).

The forecasts are based on quarterly national accounts data published by Statistics Finland in November 2020 and on other public statistical sources available by 11 December 2020.

Helsinki December 2020

Ministry of Finance Economics Department

Mikko Spolander
Director General

Jukka Railavo
Senior Financial Advisor
Head of Macro Forecasting

Marja Paavonen
Senior Financial Advisor
Head of Public Finance

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Preface

Although the COVID-19 pandemic remains the single most important determinant of the economy, a lot of things have changed during the autumn.

While short-term prospects have deteriorated, we have gained a clearer idea of the progress of the disease.

The acceleration of the pandemic and the restrictions introduced to contain it have halted the economic recovery that had got off to a brisk start in the summer and early autumn. According to the Ministry of Finance's forecast, the Finnish economy will not grow during the last quarter of 2020, nor the first quarter of 2021.

However, there are reasons to believe that as the summer approaches the pandemic will begin to wane when the percentage of those vaccinated reaches a sufficiently high level. At the same, the natural seasonal fluctuation typical of epidemics – which suppressed the disease last summer and now makes it spread faster – will start having a retarding effect.

When the pandemic abates, the economy will receive a new boost. Uncertainty will be dispelled, confidence in the future will rise, households will start spending the savings put aside during the pandemic and companies will launch investments left pending. When this happens across the world, exports will also pick up. The Ministry of Finance's forecast predicts a recovery in the second quarter of 2021. During the second half of the year, the economy will grow at a brisk pace.

After its growth spurt, the economy will return to the growth track determined by the resources available. Since the population is ageing, labour input will not increase and economic growth will depend on improved productivity. Hence, we need to be prepared for a modest average growth rate of 1-1½% over business cycles. Admittedly, the growth rate may exceed this projection in a boom, but it will, conversely, remain below the average in a recession.

The pandemic has meant exceptional times both in the economy and society. Companies and employment have been sustained by government efforts and extensive measures have been taken to provide financial support for municipalities, which will no longer be justified once the pandemic is over.

When it becomes apparent that Finland is overcoming the pandemic, it would be advisable to shift the focus in economic policy from acute crisis management to reinforcing the necessary prerequisites for growth and balancing general government finances. As a result, political attention will return to the developments that are reshaping the Finnish society, economy and the management of central and local government finances: demographic change, climate change, adoption of new technology and the adjustment of public finances to the framework determined by said factors.

Prime Minister Marin's government has adopted a plan that determines the overall direction and scale of the measures to reinforce public finances and halt public borrowing relative to gross output during the current decade. A key objective of the plan is to contribute to more efficient revenue generation and improve the level of performance in the public sector.

Along with this plan – the road map for sustainable public finances – the Government has launched a sustainable growth programme for Finland to help the economy recover from the downturn caused by the pandemic, and promote the restructuring of the labour market and business sector and the reform of public services. The programme's priorities include education, research and innovation, the green economy, competitiveness of Finnish manufacturing, digitalisation, the operation of the labour market as well as social and healthcare services and their impact – all areas in which efforts to promote change will support more efficient revenue generation and public sector performance.

The next milestone in decision-making will be the Government's mid-term review and the negotiations on the General Government Fiscal Plan in April 2021. It is of great importance to translate the preparations into tangible investments, new ways of working and other reforms to the social structures that shape economic activities, employment, productivity and competitiveness. The operating environment is changing at a fast pace, and our competitors will not wait for us to catch up.

At the same time, it is advisable to return to the old normal in the establishment of economic policy objectives. Under the Fiscal Policy Act and the Decree on the General Government Fiscal Plan, the Government is required to define objectives for the central and local government financial position as well as that of social security funds . Those objectives should lead to smaller deficits and government debt relative to gross output in the medium term.

The establishment of these objectives is not just a legal exercise. As a result of the COVID-19 pandemic, the imbalance of general government finances is exceptionally grave and public debt has reached unprecedented levels. Moreover, due to the ageing population, public spending appears to continue to grow faster than revenues.

Occasional deficits, even if large, will not upset public finances, if those financing the deficits remain unshaken in their belief in the stability and responsibility of our economic policy. So far, this is the case.

However, a rapid increase in debt and liabilities invariably exposes general government to enhanced risks. More efficient revenue generation, improved public services and judicious public spending provide the best tools for preventing these risks from being realised, and guarantee a steady and thriving economy and high-standard public services for the Finnish people in the future. Hence, they lie at the heart of any stable and responsible economic policy.

Summary

Economic outlook for 2020–2023

A definite recovery of the economy from the COVID-19 pandemic will not take place until 2021 because the second wave will temporarily slow down growth at the turn of the year. Domestic demand for services will remain weak. Exports and industrial production are suffering from the continued pandemic and will not attain growth until 2021. GDP is expected to contract by 3.3% in 2020, to be followed by 2.5% growth in 2021.

The forecast is based on the assumption that stringent restrictions will be imposed at the end of the year to press down the COVID-19 incidence rate. If the rate increases again when the restrictions are relaxed, they may have to be retightened in early 2021. This increases economic agents' uncertainty and economic recovery to normal in spring 2021 is harder. The foreseen introduction of vaccines in the spring will inspire greater confidence in the future and contribute to a gradual transition to regularity.

The economy is expected to recover when the uncertainty caused by the pandemic is dispelled in the course of 2021. Growth in demand items that will accelerate towards the end of 2021 will give an additional boost to the economy in 2022. GDP is expected to grow by 2.0% in 2022 and 1.4% in 2023. In the medium term, growth in labour input will slow down. However, the foreseen 1.3–1.4% growth rate will beat the increase in potential output.

The deficit in general government finances will remain substantial in 2021 as the healthcare efforts required to deal with the pandemic and the support measures to alleviate its effects keep public expenditure at a high level. The deficit will gradually shrink when things get back to normal. However, the imbalance between revenue and expenditure will remain so large that public debt in relation to GDP appears to continue to grow throughout the first half of the 2020s.

Evolvement of pandemic shapes economic development

The world economy will recover from the deep recession caused by the COVID-19 pandemic during the latter half of 2021. World trade has been recovering from the collapse caused by the pandemic since last summer, and the situation will gradually normalise.

The Chinese economy has almost been restored to pre-crisis levels. Exports are thriving and even retail trade has recovered from the collapse in the early 2020.

As a result of the second wave of the pandemic, the European economy will contract again in the last quarter of 2020 after the short boost in the previous quarter. Extensive restrictive measures taken in the various countries will hamper economic activity and the prospects for services demand remain uncertain.

The second wave of the pandemic has also delivered a blow to the US economy. Gross output will recover in 2021 as a result of improved employment and revived economic activity. Growth will be supported by robust stimulation measures.

The recovery continues after a short impediment

GDP is expected to decrease by 3.3% in 2020 because the economy will contract again in the last quarter of the year. Service consumption will decline again due to the second wave of the pandemic, whereas demand for goods will remain strong. Similarly, foreign trade in goods is expected to pick up to some extent, but service exports will continue to decrease. Construction investments will decline and further aggravate the fall in investments.

In 2021, GDP growth will accelerate to 2.5%. While economic growth will remain low early in the year, the economy will gradually normalise. Private consumption will increase by 3.8% in 2021, whereas goods consumption will reach the pre-pandemic level in the first half of the year. Service consumption is expected to recover more slowly and consumer confidence will be gradually restored.

Growth in private investments will still remain modest in early 2021 because of overall uncertainty. It is also expected that building starts will be postponed and residential construction investment will continue to decline.

World trade is growing again, which has had a favourable impact on foreign trade in goods. Towards the end of 2020, the second wave of COVID-19 will slow down recovery and also result in retarded growth in early 2021. Foreign trade in services shrank substantially in 2020. Stronger growth is not expected until the end of 2021. Any normalisation of travel and transport services in particular in 2021 will very much depend on whether the risks associated with COVID-19 pandemic are dispelled.

New restrictions will further reduce the demand for and supply of services and result in another dip in unemployment. Employment will decline by 1.5% in 2020, but only 0.3% in 2021.

Aside from redundancies, companies have sought savings in labour costs through lay-offs. The number of those laid off decreased quickly in the summer from the record levels, but the trend was again reversed in the autumn. The unemployment rate will reach 7.8% in 2020 and 8.0% in 2021.

Because of the weak and uncertain economy, the labour market offers few job opportunities because the number of those outside the labour market has been growing this year. Still, job opportunities are available. The number of vacancies in the third quarter was 43,000, only slightly less than in 2019.

Nominal earnings will increase by 1.7% in 2020 because of wage drift. Measured by the national consumer price index, the inflation rate is estimated to reach 0.3%. A substantial contraction of consumer demand and uncertainty about the future development of the economy will also keep the inflation in check in the coming years. In 2021, wage and salary earnings will increase by 2.5% but inflation will only accelerate at the modest rate of 1.0%.

GDP is expected to grow by 2.0% in 2022 and 1.4% in 2023. As economic growth will accelerate towards the end of 2021, it will also give an additional boost to the entire year. Consumption growth will slow down to 2.5% in 2022 and further to

1.8% in 2023. The household saving rate will stay positive throughout the forecast period while consumption will remain below disposable incomes.

Overall, the growth of private investment will be modest. The average growth rate in private investments will remain close to zero during the forecast period, which means that the ratio of investments to GDP will be about 19% at the end of the period. In 2022 and 2023, residential building starts will begin to approach the long-term average, to be followed by an increase in residential construction investment. Stronger demand, both at home and abroad, will encourage investments in machinery and equipment. Moreover, the likelihood of the launch of major industrial projects will increase towards the end of the forecast period.

Goods exports will increase driven by the recovery of the export markets and reach the pre-pandemic level by 2023. Increased output by export companies will increase demand for imported components, which will maintain the growth in imports towards the end of the forecast period. Another factor sustaining import growth is the recovery of service imports. However, investments will increase slowly in the next few years, which is likely to dampen demand for imports.

The biggest fall in unemployment will take place in 2022 and 2023 when the economy recovers from the pandemic and the restrictions are lifted. In 2023, the employment rate will fall to little over 7%, which is still slightly higher than the level of structural unemployment estimated using the method developed by the Commission.

With increased earnings and improved employment, the sum of wages and salaries is expected to grow at an annual rate of 2% in 2022–2023. In 2022 and 2023, the national consumer price index is expected to rise by 1.4% and 1.6%, respectively. Pay increases will be gradually transmitted to the price of services.

General government deficit remains substantial in 2021

The imbalance between public revenue and expenditure will be sharply aggravated in 2020. However, the deficit is expected to grow less than foreseen despite the re-acceleration of the COVID-19 pandemic in the autumn. The Finnish economy and employment performance appear to survive 2020 with less damage than many other countries. In the course of the current year, decisions have been made on a range of support measures in connection with supplementary budgets, but all the funds will not be disbursed in 2020 because part of the financing will be provided in 2021. Moreover, the pandemic situation has resulted in a fall in the use of public services, which has curbed the growth in public expenditure in 2020.

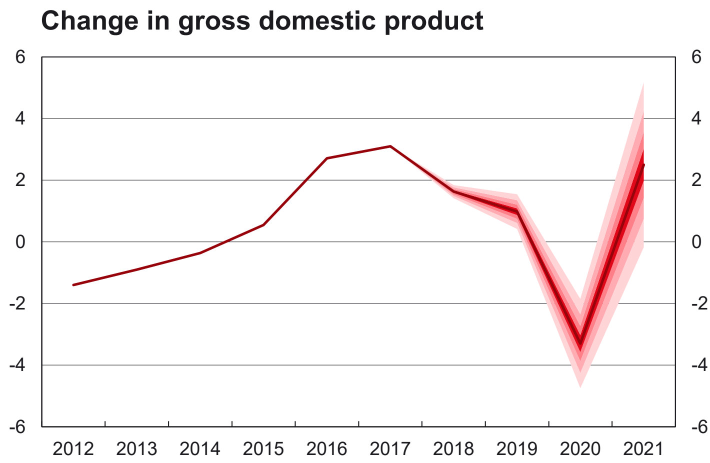
The COVID-19 pandemic, which will spill over to 2021, and the Government actions taken to support companies, citizens and the economy will mean a substantial deficit in general government finances in 2021. The postponement of non-urgent medical treatment during the pandemic will cause a backlog in services and healthcare, which will mount pressures to increase social and healthcare expenditure once the pandemic lets up.

In 2020, public debt will increase from less than 60% to 69% relative to GDP. The growth of the debt ratio will slow down in 2021 when the pandemic abates and economic recovery sets in. However, the imbalance between public revenue and expenditure and the automatic increase in expenditure due to the ageing population will continue to contribute to the increase in the debt ratio in the coming years. The public debt ratio is estimated to reach 75% in 2025.

Uncertainty of economic prospects

Consumer confidence and economic performance will remain weak until the pandemic is tamed with vaccines or otherwise.

The uncertainty of the economic forecast can be illustrated by the confidence intervals based on previous forecast errors. Accordingly, there is an 80% probability that GDP growth will settle to between -4.8% and -1.9% in 2020. Similarly, there is an 80% probability that GDP growth will be in the region between -0.2% and -5.2% in 2021. Economic growth may fall outside the confidence interval especially if there is exceptional uncertainty associated with the growth estimates.



The growth rate may fall short of the projections in a situation in which infections continue to increase in number because of delayed or ineffective restrictions. An increased need for hospital care would later lead to far more stringent restrictions, which would further slow down economic growth.

A growing number of cases and increased need for hospital care would greatly undermine confidence in the economy, which would have a significant detrimental impact on growth. At the same time, the extent of the economic repercussions depends on the government actions taken to curb the pandemic and support the economy. [1]

Quicker access to vaccines, more extensive coverage and improved efficacy would speed up recovery. The confidence-enhancing effect of vaccines may be greater than foreseen, and the economy may be able to normalise earlier. In particular, it would mean a faster and more intensive recovery of services both at home and abroad.

Robust measures to stimulate production and demand are being planned and prepared within the EU. Once these measures are implemented along with the stimulation package adopted by the Finnish Government, they would have a favourable impact on production both in Finland and other countries.

1 The economic effects of the COVID-19 pandemic. Palmén. Ministry of Finance publication 2020:84, http://urn.fi/URN:ISBN:978-952-367-710-4

Table 1. Key forecast figures

	2019	2018	2019	2020**	2021**	2022**	2023**
	EUR bn	change in volume, %					
GDP at market prices	241	1.5	1.1	-3.3	2.5	2.0	1.4
Imports	96	5.4	3.3	-7.5	4.5	3.8	2.0
Total supply	**336**	**2.6**	**1.7**	**-4.5**	**3.0**	**2.4**	**1.5**
Exports	97	1.7	7.7	-10.4	5.0	4.6	2.2
Consumption	181	1.7	0.9	-2.3	3.6	1.5	1.0
private	126	1.8	0.8	-3.9	3.8	2.5	1.8
public	55	1.6	1.1	1.4	3.1	-0.7	-0.7
Investment	57	3.9	-1.0	-3.3	-1.6	2.4	2.2
private	47	3.7	-1.6	-6.0	-2.0	3.8	3.7
public	10	5.0	2.1	9.0	0.1	-2.7	-3.8
Total demand	**336**	**2.5**	**1.8**	**-4.3**	**3.2**	**2.6**	**1.7**
domestic demand	240	2.9	-0.4	-1.8	2.6	1.9	1.5

Table 2. Other key forecast figures

	2018	2019	2020**	2021**	2022**	2023**
GDP, EUR bn	234	241	235	245	253	261
Services, change in volume, %	2.4	1.2	-3.3	2.6	2.5	1.1
Industry, change in volume, %	-2.0	3.7	-3.8	3.3	2.6	1.7
Labour productivity, change, %	-1.0	0.2	-0.7	2.1	1.4	0.6
Employed labour force, change, %	2.6	1.1	-1.5	-0.3	0.9	0.7
Employment rate, %	71.7	72.5	71.5	71.5	72.3	72.8
Unemployment rate, %	7.4	6.7	7.8	8.0	7.6	7.2
Consumer price index, change, %	1.1	1.0	0.3	1.0	1.4	1.6
Index of wage and salary earnings, change, %	1.7	2.1	1.7	2.5	2.0	2.0
Current account, EUR bn	-4.1	-0.5	-2.5	-2.5	-1.9	-1.7
Current account, relative to GDP, %	-1.8	-0.2	-1.0	-1.0	-0.7	-0.7
Short-term interest rates (3-month Euribor), %	-0.3	-0.4	-0.4	-0.5	-0.4	-0.4
Long-term interest rates (10-year govt. bonds), %	0.7	0.1	-0.2	-0.3	-0.3	-0.2
General government expenditure, relative to GDP, %	53.4	53.3	57.8	57.3	55.0	53.9
Tax ratio, relative to GDP, %	42.4	42.2	41.7	42.4	42.0	41.7
General government net lending, relative to GDP, %	-0.9	-1.0	-6.1	-5.2	-3.3	-2.6
Central government net lending, relative to GDP, %	-1.2	-1.2	-6.1	-4.9	-2.8	-2.4
General government gross debt, relative to GDP, %	59.6	59.3	69.0	71.4	72.5	73.6
Central government debt, relative to GDP, %	44.9	44.2	53.1	55.6	56.3	57.3

Medium-term outlook for 2024 and 2025

In 2020, the Finnish economy will contract as a result of the COVID-19 pandemic and the measures taken to contain it. Recovery will take place in 2021–2022. The pre-crisis level of GDP will be reached in 2022. In the medium term from 2024 to 2025, the economy will grow at a rate of nearly 1.5%, slightly faster than potential output.[1]

The impact of the change in labour input on potential output is minor in 2020 and in the short term. By the mid-2020s, labour input will begin to fall as the working-age population decreases and the labour participation rate ceases to improve. Another factor limiting the growth of labour input is structural unemployment. As a result of the recession, unemployment will increase and part of it may be converted into long-term unemployment as the out-of-work periods become longer.

Aside from labour input, the production conditions in an economy are affected by capital stock. Due to the recession and increasingly uncertain prospects, the investment rate will fall and slow down the growth of potential output relative to the pre-crisis period. The growth of capital stock will boost potential output by less than 0.5% per year.

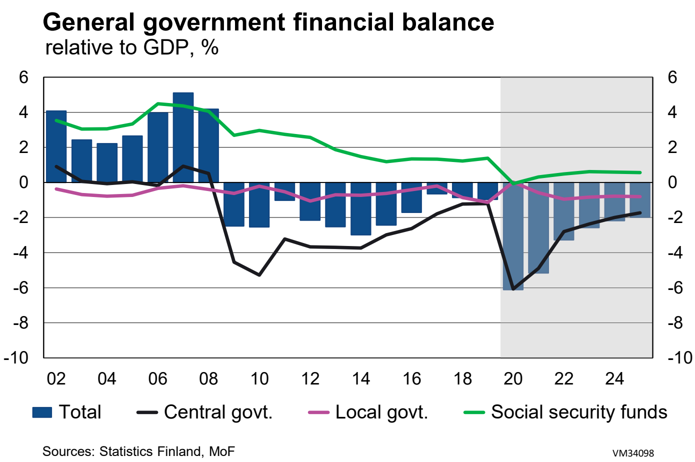
A third source of potential output is total factor productivity. Over the past few years, it has been growing more than at the beginning of the 2010s. By contrast, productivity growth has been weak compared with the early 2000s. Slow growth is explained by economic restructuring, among other things. The output of high-productivity sectors has declined and services have been gaining ground in the overall structure of the economy. In the medium term, the total factor productivity growth trend is expected to reach slightly over 0.5%, while the average in the early 2000s was over 2%.

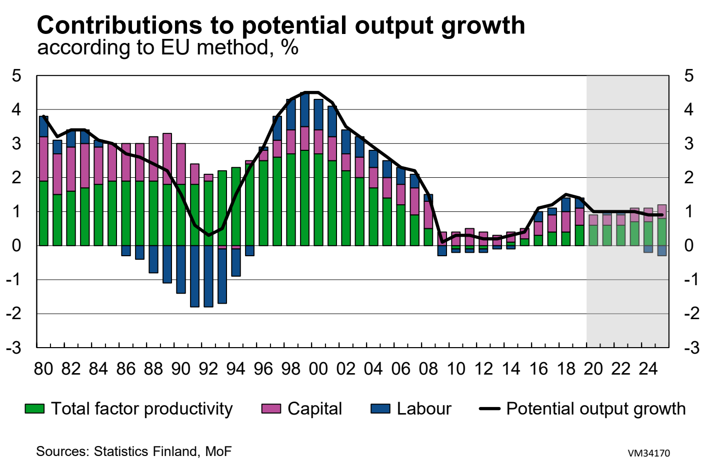
1 Medium-term prospects can be assessed in terms of potential output which is assumed to determine the necessary preconditions for growth. In estimating potential output, the Ministry of Finance applies the production function method, developed jointly by the EU Commission and the Member States, in which the growth in potential output is divided into estimates of the development of potential labour input, capital and total productivity. The potential output and output gap are unobservable variables, the estimation of which is subject to uncertainty, especially during intense economic cycles and rapid changes in the structure of production.

Table 3. Key forecast figures for the medium term

	2019	2020**	2021**	2022**	2023**	2024**	2025**
GDP at market prices, change in volume, %	1.1	-3.3	2.5	2.0	1.4	1.4	1.3
GDP, EUR bn	241	235	245	253	261	270	279
Consumer price index, change, %	1.0	0.3	1.0	1.4	1.6	1.6	1.7
Unemployment rate, %	6.7	7.8	8.0	7.6	7.2	7.0	6.8
Employment rate, %	72.5	71.5	71.5	72.3	72.8	73.2	73.4
General government net lending, relative to GDP, %	-1.0	-6.1	-5.2	-3.3	-2.6	-2.2	-2.0
Central government	-1.2	-6.1	-4.9	-2.8	-2.4	-2.0	-1.7
Local government	-1.1	0.0	-0.6	-1.0	-0.8	-0.8	-0.8
Social security funds	1.4	-0.1	0.3	0.5	0.6	0.6	0.6
Structural balance, relative to GDP, %	-1.4	-4.0	-3.9	-2.6	-2.1	-1.9	-2.0
General government gross debt, relative to GDP, %	59.3	69.0	71.4	72.5	73.6	74.4	75.0
Central government debt, relative to GDP, %	44.2	53.1	55.6	56.3	57.3	57.9	58.3
Output gap, % of potential output[1]	0.6	-3.6	-2.2	-1.2	-0.9	-0.4	0.0

[1] Estimated according the method developed jointly by the EU Commission and Member States





A LOOK AT FINNISH EXPORTS

This box provides a brief overview of the role of exports in the Finnish economy over time, including their contribution to value creation and regional and sectoral developments. It is important to acquire up-to-date background information on this subject. For one thing, the potential benefits to the Finnish economy to be gained through exports have been highlighted in the debate on the EU recovery instrument. As we gain more information and understanding of the globalisation of the economy, it is advisable to take a look at the recent trends in exports and the latest data on the related value chains.

New information has been gleaned on the importance of global value chains and the value added generated by exports from increasingly detailed company-level data (OECD and Statistics Finland 2020). According to said information, Finland is more dependent on global value chains than previously assumed (see OECD 2018). More than one third of the gross value added of exports is foreign content. The same estimate suggests that the increase in value generated by service sectors exceeds that of industry (Statistics Finland and OECD 2020). Similarly, previous estimates of the added value generated by exports have identified a downward trend in domestic value added content (Haaparanta et al., 2017, Ali-Yrkkö et al., 2016).

Foreign trade and global value chains were addressed in a previous economic survey (Ministry of Finance 2017) prepared by the Economics Department a few years ago. At that time, it was concluded, based on databases combining input-output data from several sources (OECD's TiVA, WIOD), that as a result of the increase in foreign value added content, exports are less able to increase GDP and that there are significant differences between individual sectors with regard to the volume of total exports and the percentage of domestic value added content. In 2018, the share of domestic value added content was the highest in the forest industry and lowest in sectors producing coke and processed petroleum products.

Finnish exports and international value chains

Over the past few decades, Finnish export companies have been compelled to adjust to the euro crisis, the loss of an important export sector and a fast-changing global environment. Finnish exports grew slowly in the 2010s and failed to reach the level achieved before the financial crisis by the end of the decade. During this period, GDP growth depended on increased domestic demand. In 2019, exports accounted for 40% of Finland's GDP, less than before the escalation of the financial crisis into a global one (45% in 2008) but slightly more than at the beginning of the decade (38% in 2010). An international comparison shows that the ratio is lower than in several other EU Member States (Figure 1).

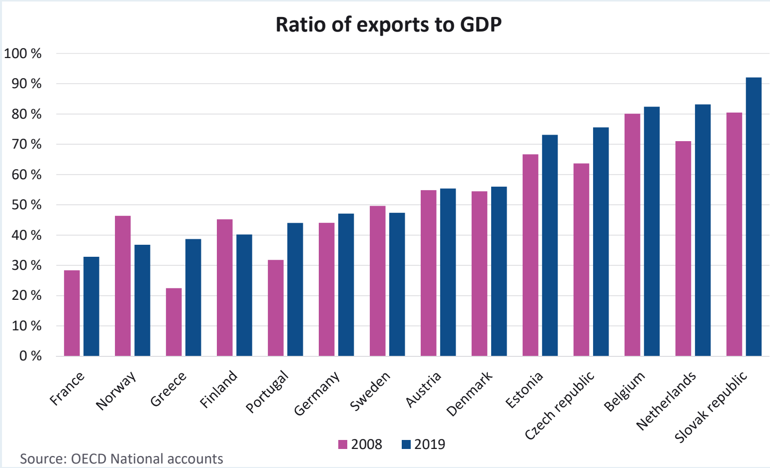


Figure 1. The ratio of exports to gross domestic product.

A more detailed illustration of the importance of exports to the economy is provided by the statistics on the value added of exports. They show how much of the value of exports is generated at home and how much abroad. The domestic value added content simply means the value added to export products by domestic inputs. Contrary to conventional wisdom, it is only this part of exports that generates revenue for the exporting country.

According to a study carried out jointly by OECD and Statistics Finland (2020), about one quarter of the Finnish GDP is directly or indirectly linked to exports, much less than previously assumed. Finnish exports incorporate a lot of foreign value added content, such as intermediate products or services produced in other countries. Hence, exports very much depend on global value chains. Compared with other countries, the share of domestic value added content in Finnish exports is average, even if it has increased since 2008 (Figure 2).[1]

1 Figure 2 is based on OECD's TiVA database from 2018. While these figures differ from Statistics Finland and OECD's joint publication (2020) based on company-level data, they are comparable as far as other countries are concerned.

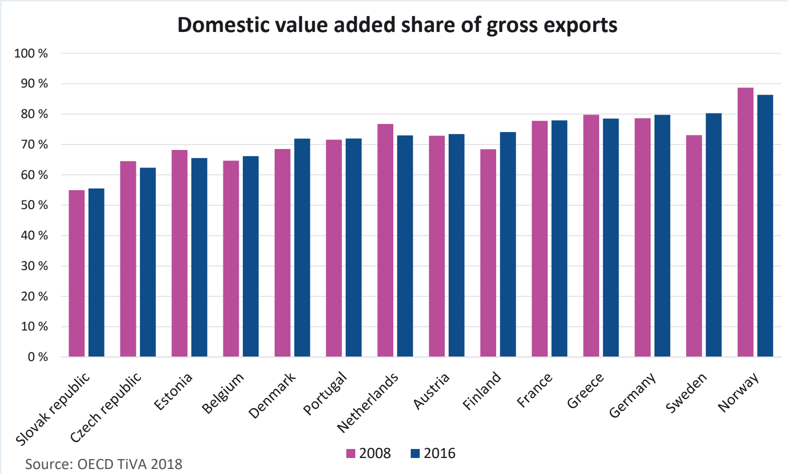


Figure 2. The domestic value added share of exports.

More exports generated by SMEs and services

Finland's goods exports are more limited in range than those of the benchmark countries. Figure 3 provides an index measuring the concentration of goods exports for Finland and the other countries included in the sample. The number is based on the Herfindahl-Hirchman index and makes use of the value of exports by sector, based on the SITCS goods classification (UNCTAD 2020). However, in 2019, exports were less concentrated than ten years earlier. Moreover, the role of large corporations in Finland's exports has diminished. From 2008 to 2018, exports growth was particularly strong in SMEs with intra-group business relationships (OECD and Statistics Finland 2020).

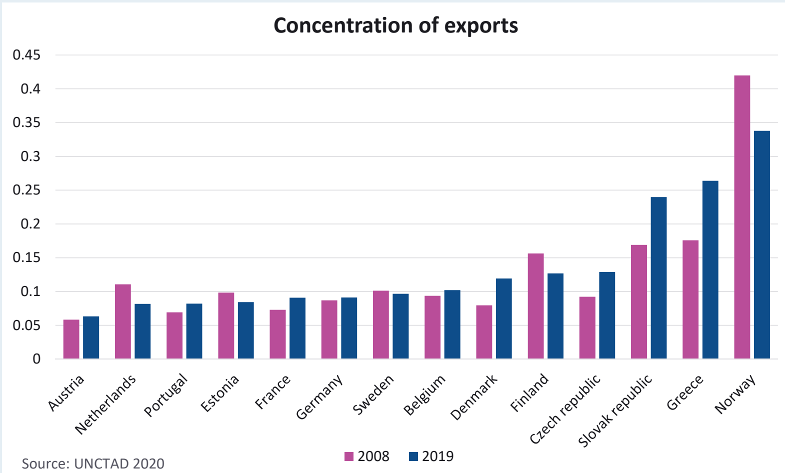


Figure 3. The concentration of exports in goods. The smaller values of the index indicate a higher diversification of exports.

Another interesting trend is the increasing share of service exports. The latest statistics released by OECD and Statistics Finland (2020) show that the service sector generated a greater percentage of value added exports (47% in 2018) than industry (44% in 2018).[2] It should be pointed out that industrial companies also have contributed to service exports because they provide industrial services. However, the COVID-19 pandemic has dealt an exceptionally heavy blow to service exports; in particular, exports by large companies suffered a sharp decline in the first half of 2020 (Lindroos et al., 2020).

Regional exports and indirect impacts

The importance of exports can also be assessed regionally at the provincial level. When doing so, it is necessary to focus on gross exports because no data on the share of domestic value added content in regional exports is available. The survey includes 18 provinces in mainland Finland as well as the province of Åland (Ahvenanmaa). The data on regional exports gleaned from customs statistics have been combined with provincial GPD data available from regional accounts. The following diagram shows regional exports relative to regional GDP. Figure 4 indicates that the ratio of exports to GDP varies substantially from one province to another.

2 According to Haaparanta et al. (2016), services exports accounted for around 36 per cent of the gross value added of exports in 2016. According to the survey conducted by Statistics Finland and OCED (2020), service exports accounted for around 46 per cent of the gross value added of exports in 2016.

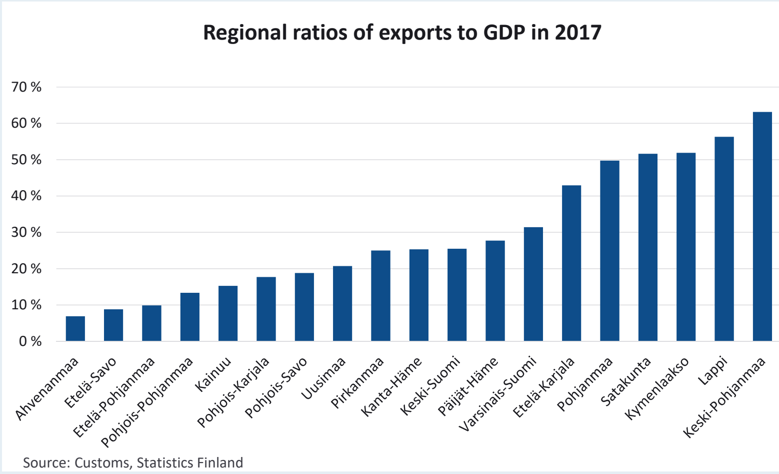


Figure 4. The regional ratios of exports to gross domestic product.

The relative share of exports is the highest in Keski-Pohjanmaa (60%) and lowest in Åland (Ahvenenmaa) and Etelä-Savo (both less than 10%). The average correlation of exports to GDP determined for all provinces is only 0.2. One reason for the low correlation is the absence of service exports in the analysis. For the Uusimaa Province in particular, the share of service exports is probably higher than the average. If service exports were included in the data, the average growth effect of exports would be stronger because the share of domestic value added content tends to be relatively high in service exports.

In other words, when measured in this way, the link between exports and GDP is usually not significant in the provinces, although a high export percentage does mean that the impact of exports in the region involved is clearly above the average.

However, by analysing the correlation between gross exports and GDP, it is not possible to determine how much of the value added content of exports is generated in that particular region. If the share of domestic value added content is high, exports may play a larger role than gross exports would suggest, which means that the correlation between gross exports and GDP fails to give a true idea of the phenomenon. Conceivably, even though exports are low, export companies may purchase products and services of high domestic value added content from these low-export provinces for inclusion in the final export products.

A number of challenges are encountered when an attempt is made to measure the indirect impacts of exports on municipal tax revenues or employment. While such indirect impacts are significant, it is difficult to determine them accurately in the absence of a close statistical analysis. Even so, some of the indirect effects of exports are discussed below.

Figure 5 lists the ten biggest municipalities in Finland in terms of tunover per number of private sector employees. In 2018, the best performance was put in by Tornio (EUR 900,000 per private sector employee). In the municipalities topping the list, there are major export companies. The diagram includes Vantaa and Helsinki, ranked 16th and 22nd, respectively.

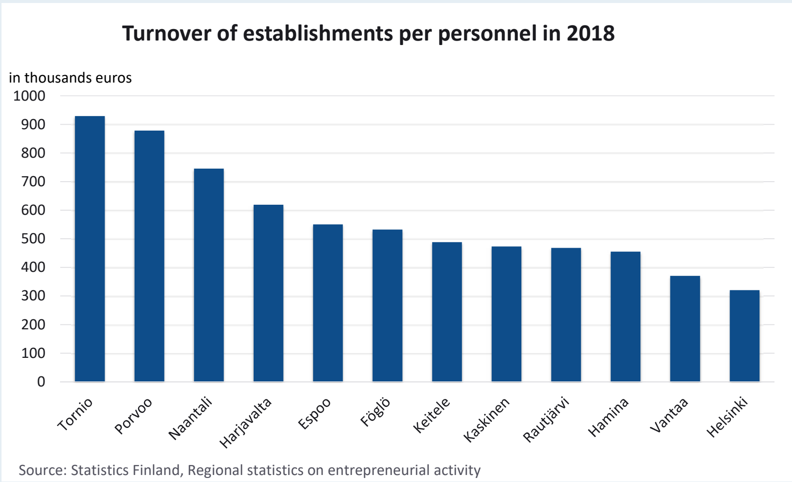


Figure 5. The turnover of private sector establishments per personnel by municipality.

Although the turnover by industry is more or less equal to that of services, the share of value added content in terms of gross value is far lower for industrial products (32%) than services (57%). One reason for this is that industry uses much more intermediate products than the service sector. The production structure of companies affects the municipal tax base and hence tax revenues. Municipal tax revenues are influenced, among other things, by the relative percentages of the unemployed, pensioners and public sector employees.

Municipal tax revenues are also affected by the jobs created indirectly by the export industry. The report by Statistics Finland and OECD (2020) estimates that there are around 500,000 jobs directly or indirectly dependent on exports. In an earlier survey carried out by Finnish Forest Industries (2018)[3], it was concluded that the number of such jobs in Finland would be around one million. According to Statistics Finland and

3 The estimates of the number of jobs created directly or indirectly by the export industry were prepared by KPMG and the University of Oulu.

OECD (2020), the employment-enhancing effects of exports are often overestimated for two reasons. On average, export sector jobs concentrate in high-productivity companies in which the number of jobs per input is lower. Additionally, the indirect effects of export companies on employment are more limited than assumed because they use more foreign inputs in their production process.

In conclusion

In Finland, the ratio of exports to GDP has declined since the financial crisis and remains below the EU average. Similarly, analyses by OECD and Statistics Finland (2020) based on more detailed data suggest that the share of domestic value added content in exports and GDP is lower than previously assumed. At the same time, the analysis reveals Finnish companies' dependency on international value chains. Export companies use foreign intermediate products and services in production, which makes them dependent not only on international demand but also on supply. Most advanced economies are similarly dependent on these value chains.

When the impact of exports is debated, attention is often drawn to both regional and indirect effects. Regionally, the ratio of exports to GDP varies greatly. For many municipalities, large export companies are important employers and taxpayers. However, an analysis of indirect effects is complicated by statistical challenges. The most recent estimates of the number of jobs generated by the export industry suggest that the impact of exports on employment is less extensive than previously believed on the basis of earlier data. This is due to the fact that the impact of exports on the Finnish economy and employment is, in the final analysis, based on the domestic value added content of exports. When value added is generated outside Finland, it does not contribute to economic growth or improved employment.

As globalisation proceeds and value chains in foreign trade expand, it would be advisable, among other things, to analyse their impact on taxation and the relocation decisions of companies in more detail. Moreover, Finland should reflect on the causes of weak economic growth after the financial crisis and its links to the future development of foreign trade. For example, the increasing role of service exports could support diversification, which would offer greater growth potential.

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1 Economic outlook

1.1 Global economy

World economy will recover in 2021

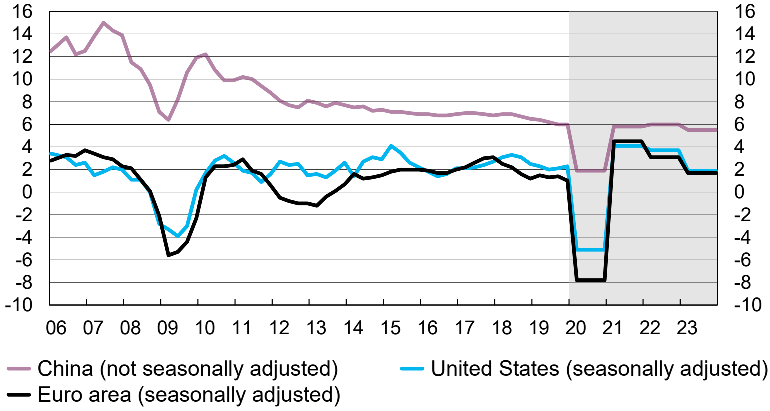
The world economy will recover from the deep recession caused by the COVID-19 pandemic during the latter half of 2021. The global economy will grow by 4.7% in 2021 and 3.8% in 2022. World trade will also recover in 2021.

As a result of the second wave of the pandemic, the European economy will contract again in the last quarter of 2020 after the short boost in the previous quarter. Extensive restrictive measures taken in the various countries will hamper economic activity and prospects for services remain uncertain. The economy will start to recover as of the second quarter of 2021. Growth in the euro area will increase by 4.5% in 2021 and 3.1% in 2022.

The second wave of the pandemic has also delivered a blow to the US economy. GDP will shrink by over 5% in 2020 but recover and grow by 4.1% in 2021 as a result of improved employment and intensive economic activity. Growth is supported by robust stimulation measures.

The Chinese economy has almost been restored to pre-crisis levels. Exports are thriving and even retail trade has recovered from the collapse in early 2020. GDP will increase by 5.8% in 2021 and 6% in 2022.

Gross domestic product
change in volume, %



Sources: Statistical authorities, MoF

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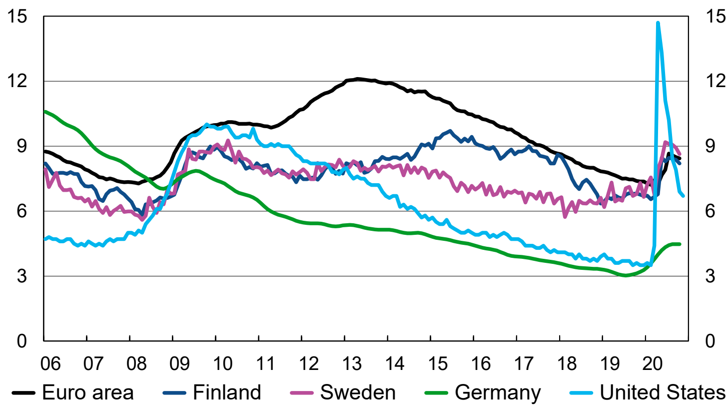
For Japan, leading indicators suggest a recovery from the COVID-19 crisis. Compared with other industrialised countries, the pandemic has been less severe in its impact on economic activity. However, due to structural reasons, the growth potential of the economy remains modest. The economy will recover and grow by 2.4% in 2021 and 1.1% in 2022.

The economic prospects for the UK are tempered by the threat of a no-deal Brexit. As the British economy is highly service-driven, the impact of the pandemic has been devastating. However, the prospects are expected to brighten in 2021 and the economy will grow by 3.4%, while the corresponding figure for 2022 will be 2.0%.

Unemployment rate
seasonally adjusted, %



Sources: Statistical authorities

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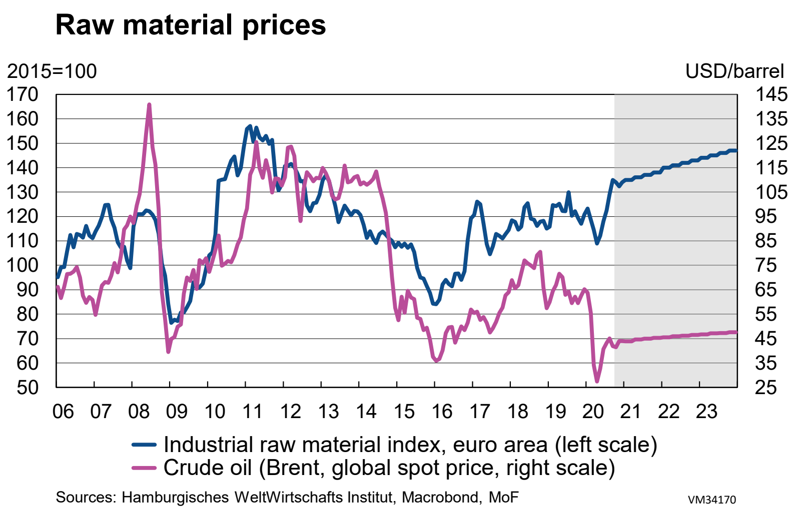
Compared with other Nordic countries, Sweden has suffered more from the COVID-19 pandemic while its containment measures have been less restrictive. Consumer confidence is high and the prospects for industry fairly positive. GDP will increase by 4.2% in 2021 and the economy grow by 2.3% in 2022.

Russia is a facing a serious COVID-19 threat. The situation has been aggravated especially towards the end of 2020. Another development affecting the prospects is the modest development in the price of crude oil. As of January 2021, Russia and OPEC countries will increase oil production moderately. GDP will increase by 3.3% in 2021 and 1.9% in 2022.

Raw material prices increasing

Raw material prices have increased during 2020 despite the pandemic. The prices of metals, including nickel, have also risen. By contrast, the price of pulp has quickly dropped from the 2018 peak. Overall, raw material prices will increase in moderation over the forecast period.



Little movement in prices

The consumer price index has been negative in the euro area since August 2020. In particular, the moderate movement in the price of energy has led to deflation. Moreover, baseline inflation has slowed down across the board. It has been decelerating in industrial countries with no sign of acceleration in the foreseeable future.

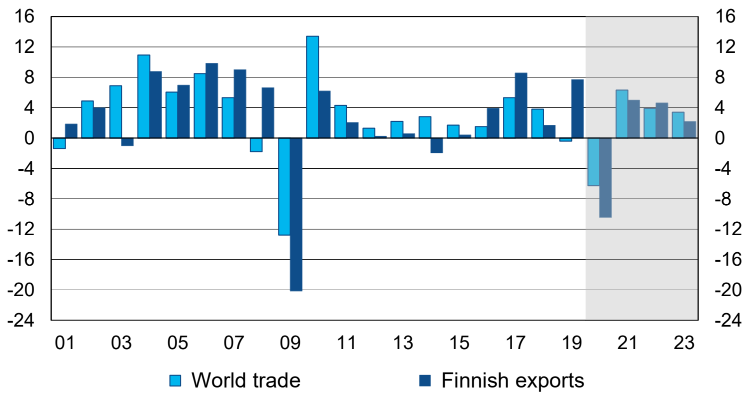
Interest rates hit record-low

Short-term market interest rates have reached an all-time low in the euro area. The rates are also low in other key economies. The interest rates on sovereign debt have fallen, whereas a slight increase can be seen in the United States. The rates are expected to rise moderately over the forecast period.

World trade recovery driven by e-commerce

World trade has been recovering from the collapse caused by the pandemic since last summer. E-commerce has grown strongly during the pandemic. World trade in goods has already reached pre-crisis levels, driven by emerging economies in particular. Goods trade will increase by 6.3% in 2021 and 3.9% in 2022.

World trade
change in volume, %



Sources: CPB Netherlands Bureau for Economic Policy Analysis, Statistics Finland, MoF VM34170

Predominantly downward risks

Most of the risks associated with economic prospects are downward risks. Conceivably, the pandemic may again be aggravated in case of a third wave in early 2021. Another risk to be reckoned with is an extensive bankruptcy wave, especially in the service industry. A break down in the Brexit talks between the EU and UK would hamper economic development in Europe.

Of the upward risks, the most important is the risk related to the availability of a COVID-19 vaccine and a faster-than-expected restoration of confidence among economic agents in the first half of 2021, which would bolster economic activity worldwide.

Table 4. Gross domestic product

	2018	2019	2020**	2021**	2022**	2023**
	change in volume, %					
World (PPP)	3.6	2.9	-4.6	4.7	3.8	3.0
Euro area	1.9	1.3	-7.8	4.5	3.1	1.7
EU	1.9	1.4	-7.4	4.1	2.7	1.5
Germany	1.3	0.6	-6.1	4.5	3.0	1.8
France	1.8	1.5	-9.7	4.9	3.1	1.7
Sweden	2.0	1.4	-3.8	4.2	2.3	1.8
United Kingdom	1.3	1.3	-9.4	3.4	2.0	1.3
United States	3.0	2.2	-5.1	4.1	3.7	1.9
Japan	0.3	0.7	-5.8	2.4	1.1	0.5
China	6.7	6.1	1.9	5.8	6.0	5.5
India[1]	6.1	4.2	-7.6	5.1	6.3	6.8
Russia	2.5	1.3	-4.5	3.3	1.9	0.9

[1] Fiscal year
Sources: Eurostat, statistical authorities, IMF, World Bank, MoF

Table 5. Background assumptions

	2018	2019	2020**	2021**	2022**	2023**
World trade growth, %	3.8	-0.4	-6.3	6.3	3.9	3.4
USD/EUR	1.18	1.12	1.14	1.18	1.17	1.16
Industrial raw material price index, EA, € (2015=100)	118.5	122.1	123.8	136.5	141.5	145.5
Crude oil (Brent), $/barrel	71.6	64.1	42.9	44.7	46.0	47.2
3-month Euribor, %	-0.3	-0.4	-0.4	-0.5	-0.4	-0.4
Government bonds (10-year), %	0.7	0.1	-0.2	-0.3	-0.3	-0.2
Export market share (2010=100)[1]	93.0	100.0	96.0	95.0	95.0	94.0
Import prices, %	3.5	0.4	-5.1	1.9	2.1	1.6

1 Ratio of export growth to world trade growth
Sources: Statistical authorities, CPB, HWWI, Reuters, MoF

IS THE WORLD ECONOMY LESS DEPEDENT ON CRUDE OIL THAN IT USED TO BE?

The accelerating climate change has led efforts to reduce the dependency on fossil energy sources in the global economy and develop renewable sources to replace oil. After the adoption of the Paris Agreement, many governments and the European Union have announced carbon neutrality goals for the coming decades. Crude oil is a key fossil fuel generating carbon dioxide emissions. The idea of replacing crude oil with energy forms that are less taxing on the climate has been in the public eye for quite some time. But has the world economy really become less dependent on oil? To answer this question, we should first look at total consumption and then the current trends in household and industrial energy needs and electricity generation, and finally the economic growth rate and long-term demand for crude oil over an extended period of time.

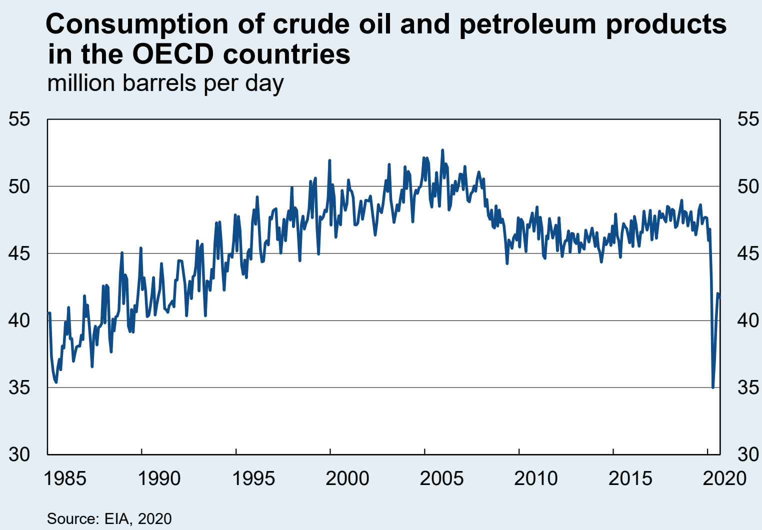


Figure 1.

Figure 1 shows the total daily consumption of crude oil and petroleum products in the OECD countries since 1980. From the 1980s, oil consumption increased steadily up to the financial crisis of 2008. Since then, the increase has slowed down or even halted. The figure also shows a sharp fall in oil consumption in spring 2020 due to the COVID-19 pandemic. Since then, consumption has recovered slightly but still remains low. Hence, the climb in the total consumption of crude oil seems to have been cut off by the global financial crisis.

In 2018, road transport accounted for almost half of all demand for crude in the OECD countries. The share of the petrochemical industry was approx. 15% and that of other industry slightly over 11%. Housing, business and agriculture combined accounted for a little less than 9%, and air travel under 8% (see Figure 2).

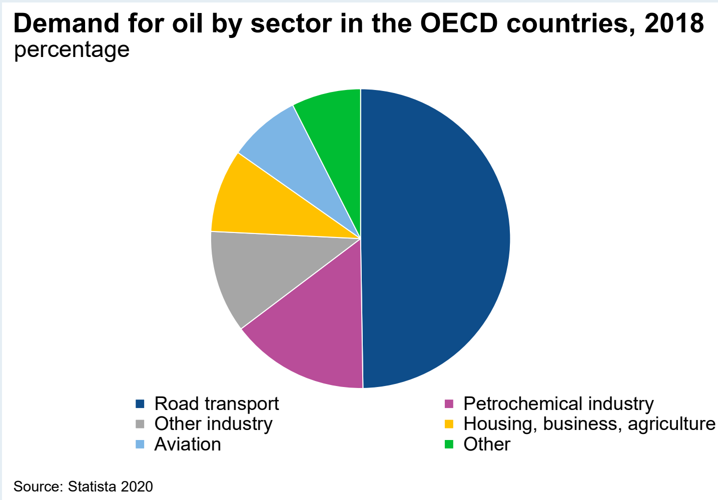


Figure 2.

Governments have taken strategic measures to replace combustion engine cars with electric and hybrid cars. Other energy sources, such as biogas, have also been developed. Although most heavy-duty vehicles continue to be powered by diesel engines, there are a number of promising developments, such as biodiesel. The number of electric cars increased by 40% relative to the previous year. A total of 7.2 million electric cars were in use. About 2.6% of new car sales were electric cars (IEA, 2020a). Leading these trends are industrial countries, notably the United States and Europe. Globally, the conventional power units still dominate.

As far as heavy industry is concerned, the key role is played by chemicals, steel and cement. The energy needs of these sectors is equivalent to the entire primary energy demand of the United States. The chemical industry, in particular, consumes huge amounts of crude oil (IEA, 2020b). The demand for plastic products is still extensive and no materials that could replace plastics are yet in sight (Lamb, 2020).

As far as residential buildings are concerned, oil heating is becoming a thing of the past, at least in Finland (Statistics Finland, 2019). Many urban areas in industrial countries have district heating networks while low-rise houses are increasingly making use of solar and geothermal energy. It should be pointed out that Finland is also at the forefront of change in this respect, together with other industrial nations. On the global scale, the change is taking longer.

Dependency on oil has also decreased in electricity generation. While electricity produced with oil accounted for 11% of all power generation in 1985, its share fell to 4% in 2019 globally (Our World in Data, BP Statistical Review of World Energy and Ember, 2020). Hydroelectric and nuclear power are traditional low-emission ways of generating electricity. Wind and solar power are already important sources of energy. Other renewable technologies are also being developed, such as wave power.

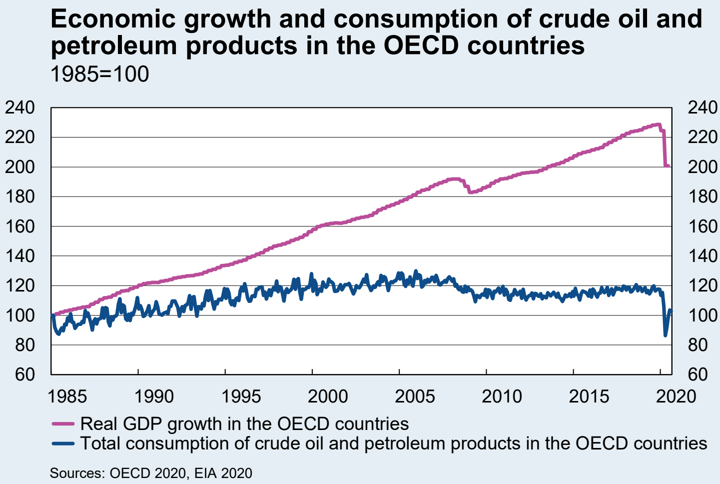


Figure 3.

Figure 3 shows the indexes for global economic growth and the increase in crude oil consumption during 1985–2020. It illustrates that when the economy grew, with the exception of the global financial crisis and the current COVID-19 pandemic, oil consumption increased at a clearly slower rate up to the financial crisis when it assumed a slightly downward trend. It appears that the link between economic growth and crude oil consumption has been weakened over the past ten years or so.

Decreased oil dependency has a range of implications for the world economy. The increased use of renewable resources slows down climate change, which is positive. However, many of the oil producers are developing countries in the Middle East, Africa and South America. Converting the industrial structure so as to focus on something other than oil drilling is a slow and arduous process in these countries. For Finland, an important fact is that Russia is one of the world's biggest producers of crude oil The Russian economy is almost totally dependent on oil and natural gas, and the country has taken few steps to reduce its oil dependency and diversify its production structure.

Sources:

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1.2 Foreign trade

World trade grew fast in the third quarter of 2020. Since the summer, trade in goods has picked up considerably around the world. However, international exports and imports of services have not followed suit. The developments in the autumn have lent added credence to the assumption that individual sectors will recover at a different pace. Finland's foreign trade in 2020 has followed this international pattern. In 2021, foreign trade in goods will recover faster than trade in services. Growth in the foreign trade in services will be hampered by the slow recovery of the travel industry, which is not expected to experience any rapid growth until the latter half of 2021, which will then spill over to 2022. Towards the end of the forecast period, by 2023, foreign trade volumes are expected to reach pre-COVID-19 levels.

1.2.1 Exports and imports

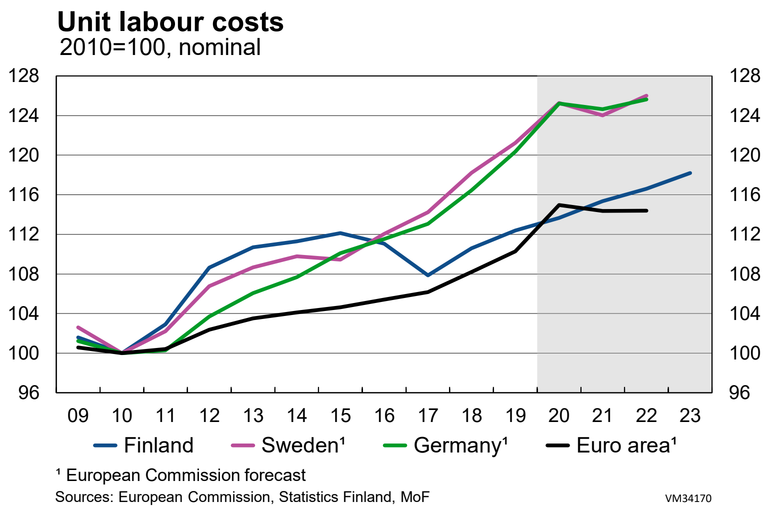
In the first half of 2020, both imports and exports declined sharply, although the fall in foreign trade volumes was not as deep as in other euro area countries on average. World trade and the demand for Finnish goods increased in the summer and autumn. This had a favourable impact on foreign trade in goods. Towards the end of 2020, the second wave of COVID-19 will slow down recovery and also result in slow growth in the first quarter of 2021. Foreign trade in services shrank substantially in 2020. Stronger growth is not expected until the end of 2021. Any acceleration of growth in travel and transport services, in particular in 2021, will very much depend on whether the risks associated with the COVID-19 pandemic are dispelled.

Export volumes are estimated to decrease by 10.4 % in 2020. The current statistics extending up to the third quarter of 2020 suggest that service exports will decline considerably more than goods exports, which already turned for the better in the third quarter relative to the previous quarter. In 2021, exports will grow by 5 %, mostly in the latter half of the year. Subsequently, exports will increase by another 4.6 % in 2022 and 2.2 % in 2023. Pre-crisis levels will be reached towards the end of the forecast period.

Import volumes will fall by 7.5 % in 2020. According to current statistics, imports of both goods and services decreased less than exports. Imports have been sustained by Finland's relatively favourable COVID-19 situation and the quick recovery of domestic consumption. Imports will grow by 4.5 % in 2021 and 3.8 % in 2022. Increased output by export companies will increase demand for imported components, which will maintain the growth in imports towards the end of the forecast period. Another factor sustaining import growth is the recovery of service imports. However, investments will increase slowly in the next few years, which is likely to dampen demand for imports. In 2023, imports are predicted to grow by 2 %.

Table 6. Foreign trade

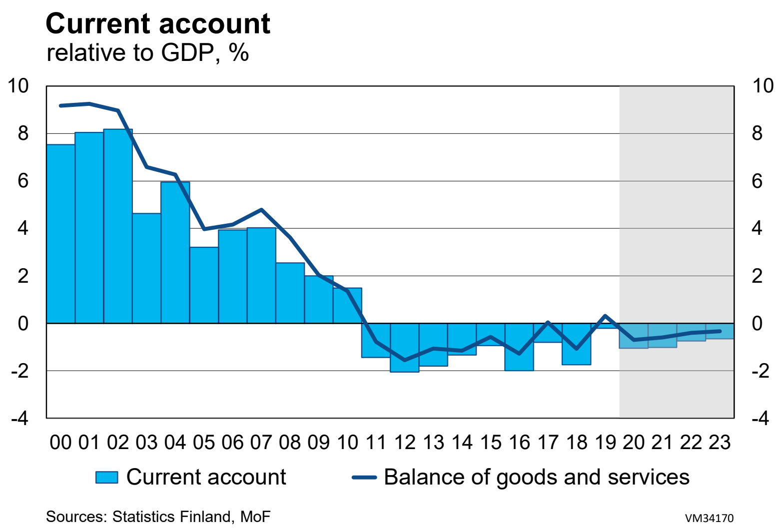
	2018	2019	2020**	2021**	2022**	2023**
	change in volume, %					
Exports of goods and services	1.7	7.7	-10.4	5.0	4.6	2.2
Imports of goods and services	5.4	3.3	-7.5	4.5	3.8	2.0
	change in price, %					
Exports of goods and services	4.2	-0.3	-4.7	1.8	1.9	1.6
Imports of goods and services	3.5	0.4	-5.1	1.9	2.1	1.6



1.2.2 Prices and current account

Export prices are expected to fall by 4.7 % and import prices by 5.1 % in 2020. The prices of both imported and exported goods fell sharply in early 2020, showing only a moderate increase in the latter half of the year. Oil and raw material prices decreased considerably in the first quarter, which was also reflected in the prices charged by certain industries. However, the prices of industrial raw materials have been rising since April, while the price of oil has persisted at a lower level.

Based on the statistics extending up to the third quarter of 2020, no equivalent decrease is evident in the import and export prices of services. Both import and export prices will rise again in 2021 and this positive trend will be sustained up to the end of the forecast period.



The terms of trade improved in the second quarter of 2020 because the prices of imported goods fell more than those of exported goods. However, in the third quarter, import prices began to rise more quickly, which again undermined the terms of trade. In 2021, import prices will continue to increase at a slightly faster pace than export prices.

In 2020, the value of imports and exports will decline as a result of reduced volumes and a fall in prices. In 2020, the value of exports will decrease faster than the value of imports, which will temporarily increase the current account deficit for goods and services, but the situation will improve in the following years. While the current account will be in deficit up to the end of the forecast period, it will shrink towards 2023.

Table 7. Current account

	2018	2019	2020**	2021**	2022**	2023**
	EUR bn					
Balance of goods and services	-2.5	0.8	-1.6	-1.5	-1.0	-0.9
Factor incomes and income transfers, net	-1.6	-1.3	-0.8	-1.0	-0.8	-0.8
Current account	-4.1	-0.5	-2.5	-2.5	-1.9	-1.7
Current account, relative to GDP, %	-1.8	-0.2	-1.0	-1.0	-0.7	-0.7

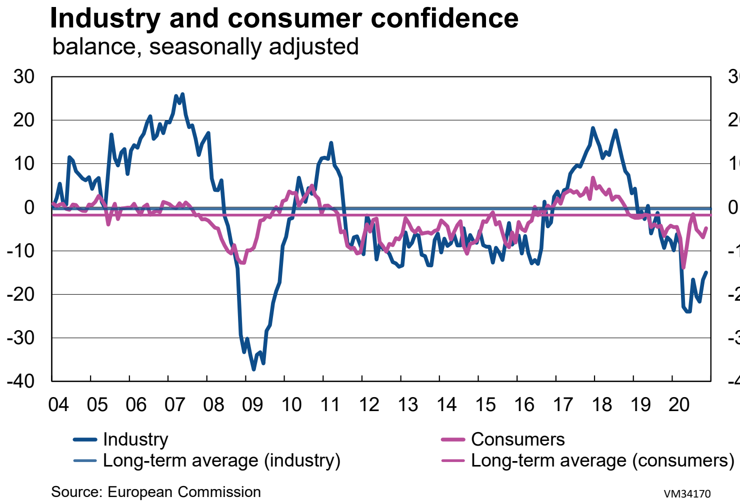
1.3 Domestic demand

1.3.1 Private consumption

Household real disposable income does not fall

Private consumption clearly recovered in the third quarter of 2020 from the massive collapse in the spring but still remained 3.6% lower than the year before.

COVID-19 has affected the structure of consumption in that the money saved in services has been spent on durable consumption goods and short-lived goods, such as groceries. From June to September, the consumption of services grew clearly from the previous quarter, yet if fell 7% year-on-year. In contrast, the consumption of durable consumer goods and short-lived goods increased compared to 2019.



According to Statistics Finland's confidence survey, the level of consumer confidence was normal in November. Advance information on the wagebill available in the income register suggests that it exceeded the 2019 level in October. The volume of retail trade grew over 4% year-on-year in October. In the autumn, the first registrations of cars fell slightly below the 2019 figures, but trade in used cars has been busy.

Due to the second wave of the COVID-19 pandemic, the consumption of services is expected to remain low in the last quarter of 2020 and first quarter of 2021. International travel services are assumed to be the last consumption category to recover, which will take place in the latter half of 2021. Service consumption is predicted to fall by 7% in 2020 but to grow by 5% in 2021.

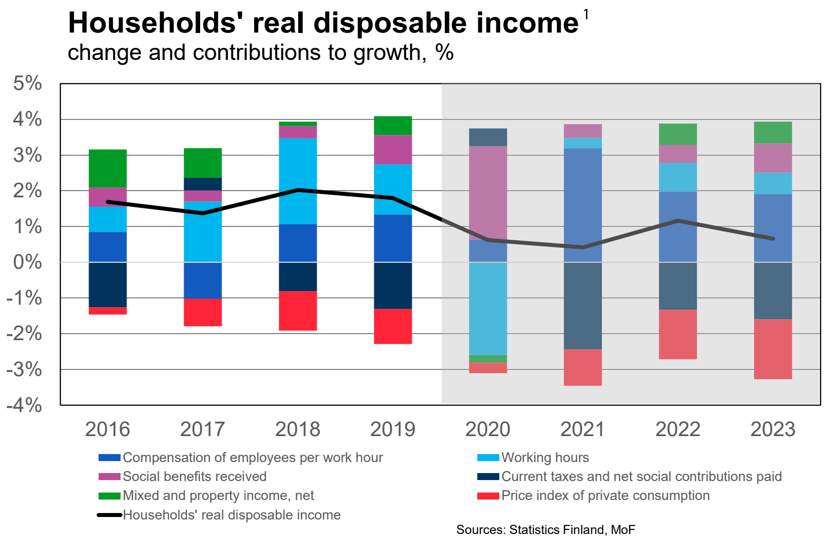
The consumption of durable goods is expected to increase by 2% in 2020 because, despite the second wave, debit/credit card payment data for November shows that goods consumption remains strong. In 2021, the consumption of durable goods will increase by 7% and that of semi-durable goods, such as clothes and footwear, by 5%.

The consumption of short-lived goods will increase by 3% in 2020 as the convenience goods trade benefits from the reduced customer footfall in restaurants. In 2021, the consumption of short-lived goods will increase by 1%.

All in all, private consumption will fall by 3.9% in 2020. In 2009 when the financial crisis hit the Finnish economy, private consumption decreased by 2.9%.

In 2021, private consumption is expected to increase by 3.8% and return to the normal level prevailing before the COVID-19 epidemic.

Consumption growth will slow down to 2.5% in 2022 and further to 1.8% in 2023. The household saving rate will remain positive throughout the forecast period while consumption will remain below disposable incomes.



[1] Current taxes and social contributions paid, as well as the price index of private consumption have negative signs in graph, since their growth decreases real disposable income. The contribution of compensation of employees has been separated to a change in working hours and to a change in the compensation of employees per hour.

From 2016 to 2019, the real disposable income, which reflects the aggregate purchasing power of households, increased at an average annual rate of 2%. In the diagram, the taxes and social security contributions paid, as well as the price of private consumption, are shown as negative values, because any increase in these items reduces the real disposable income of households.

During 2020–2021, real disposal income is predicted to increase at a much slower rate, at about half a percent per year.

In 2020, disposable real income is diminished, in particular, by the reduced number of hours worked due to lay-offs and increased unemployment. A lower number of hours automatically decreases household earnings even if average earnings per hours worked increase slightly.

However, the fall in worker compensation is offset by cash benefits, such as unemployment allowances, which will increase sharply in 2020. Moreover, the taxes and social security contributions paid will serve as automatic stabilisers that will, exceptionally, fall in 2020 as a result of the reduced wagebill, and so increase the purchasing power of households.

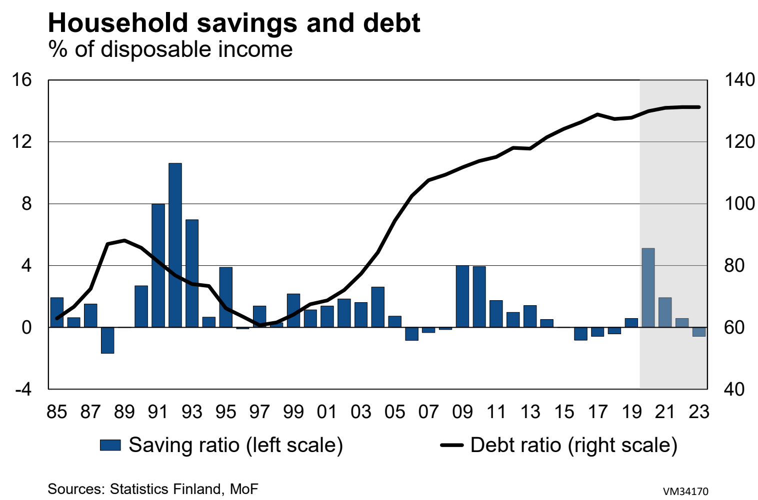


Table 8. Consumption

	2019	2018	2019	2020**	2021**	2022**	2023**
	share, %	change in volume, %					
Private consumption	100.0	1.8	0.8	-3.9	3.8	2.5	1.8
Households	95.4	1.9	0.9	-3.9	3.8	2.6	1.8
Durables	7.7	4.5	2.9	2.4	7.1	1.0	2.8
Semi-durables	7.5	2.3	2.4	-7.4	5.0	2.5	2.5
Non-durable goods	27.0	0.3	-0.8	2.7	0.9	0.3	0.8
Services	53.3	2.4	1.7	-7.5	4.7	3.9	2.2
Consumption by non-profit institutions	4.3	-1.3	-0.5	-3.0	3.0	1.0	1.0
Public consumption		1.6	1.1	1.4	3.1	-0.7	-0.7
Total		**1.7**	**0.9**	**-2.3**	**3.6**	**1.5**	**1.0**
Households´ disposable income		3.1	2.8	0.9	1.4	2.6	2.3
Private consumption deflator		1.1	1.0	0.3	1.0	1.4	1.7
Households´ real disposable income		2.0	1.8	0.6	0.4	1.2	0.7
		%					
Consumption in relation to GDP (at current prices)		75.8	75.4	76.2	77.0	76.5	76.3
Household savings ratio		-0.4	0.6	5.1	1.9	0.6	-0.6
Household debt ratio[1]		127.4	127.8	130.0	131.0	131.2	131.2

[1] Household debt at end-year in relation to disposable income.

1.3.2 Public consumption

The largest items in public consumption expenditure are personnel expenses, and goods and services purchased. Local government consumption accounts for approximately two thirds and central government consumption for less than one-third of aggregate public consumption, with consumption by social security funds making up for the remainder.

The increased need for services due to the ageing population, the front-loaded spending increases implemented by Prime Minister Marin's Government and the support measures and additional spending necessitated by the COVID-19 pandemic increase public consumption expenditure in 2020. However, this increase appears to fall short of the foreseen levels. As a result of the postponement of non-urgent medical care and the restrictions imposed on public services, one-off savings have been generated that have put a damper on the increase on consumption expenditure and deferred part of it and the healthcare backlog to the coming years.

The growth in public expenditure is expected to accelerate in 2021. As a result of the COVID-19 pandemic and the measures to contain it, substantial expenses will be incurred in general government finances next year due to testing, vaccinations, etc. Additionally, fixing the service and healthcare backlog is expected to create spending pressures when the pandemic eases off.

The growth in public consumption expenditure will also continue during 2022–2025, but the volume of consumption will decline in 2022–2023 when the additional spending due to COVID-19 and other one-off spending increases come to an end.

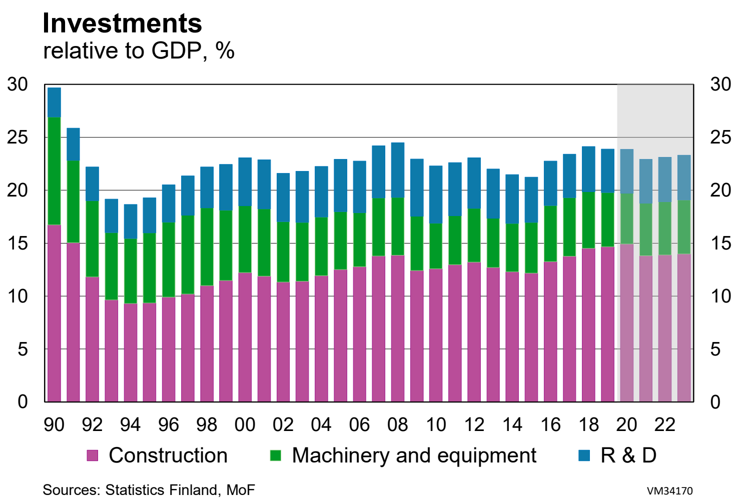
1.3.3 Private investment

Uncertainty lingers in the investment environment

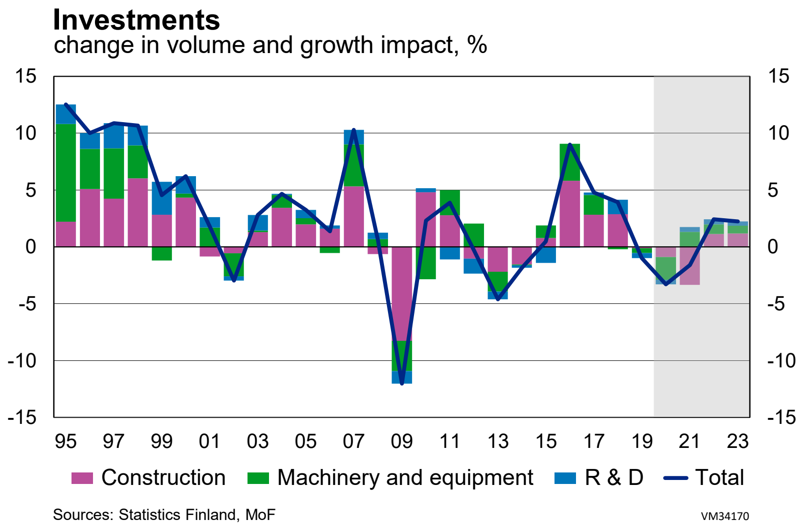
The instability of the world economy will continue to discourage investors even in 2021. Construction will decrease less than predicted in 2020 but the dive will get deeper in 2021.

During the first three quarters of 2020, private investments fell by 4.2% year-on-year. The forecast foresees a decline in private investments: 6.0% in 2020 and 2.0% in 2021. Growth will be weakest in the last quarter of the current year and remain so still in 2021 because of overall uncertainty. All in all, the growth of private investments will be modest in the next few years. The average growth rate in private investments will remain close to zero during the forecast period, which means that the ratio of investments to GDP will be about 19% at the end of the period.

New residential construction will fall sharply in 2021, to be followed by increased housing investments in 2022. While the number of residential buildings starts was clearly above the average during the first three quarters of 2020, the trend in planning permissions was weaker. Consequently, as the number of buildings starts will most likely fall, the forecast predicts a 6% decrease in residential construction investment. It is also expected that building starts will be postponed. After 2021, housing starts will begin to approach the long-term average, to be followed by an increase in residential construction investment in 2022 and 2023.



Other construction investment will decline slightly this year, and this trend will intensify in the next. The number of starts in industrial, commercial and office construction is low. Civil engineering investments will grow at the beginning of the forecast period thanks to infrastructure investments. Growth will level off in 2021 and continue after that at an annual rate of 1.3%.



Investments in machinery, equipment and transport fleet will decrease considerably in 2020 but will recover in 2021 when the business environment becomes more predictable. Towards the end of the forecast period, stronger demand, both at home and abroad, will encourage investments in machinery and equipment. Moreover, the likelihood of launches of major industrial projects will increase towards the end of the forecast period. Investments in machinery and equipment will grow by 3.9% in 2022 and 3.2% in 2023. Research and development will decrease at the beginning of the forecast period but then grow throughout the period.

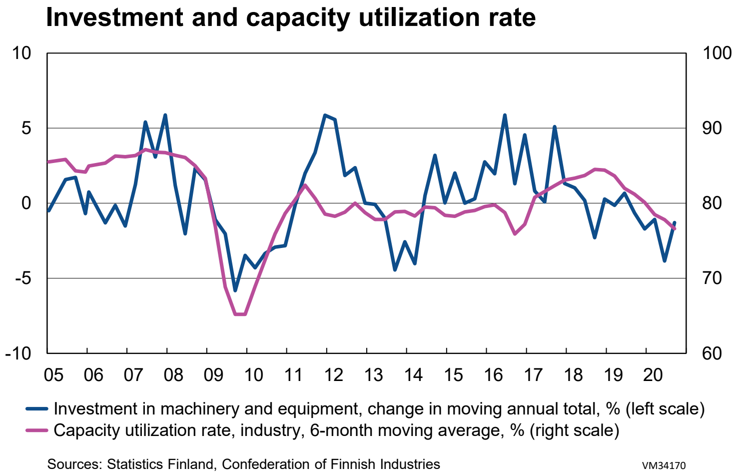


Table 9. Fixed investment by type of capital asset

	2019	2018	2019	2020**	2021**	2022**	2023**
	share, %	change in volume, %					
Buildings	52.5	5.8	0.5	-2.2	-6.0	2.0	2.1
Residential buildings	30.2	4.5	-2.1	-2.0	-6.0	2.0	1.9
Non-residential buildings	22.3	7.8	4.1	-2.5	-6.0	2.0	2.3
Civil engineering construction	8.8	0.1	-4.0	3.1	-1.5	1.3	1.3
Machinery and equipment	21.6	-0.8	-1.8	-9.3	6.5	3.9	3.2
R&D-investments[1]	17.2	7.2	-2.6	-2.3	2.5	2.5	2.0
Total	**100.0**	**3.9**	**-1.0**	**-3.3**	**-1.6**	**2.4**	**2.2**
Private	82.1	3.7	-1.6	-6.0	-2.0	3.8	3.7
Public	17.9	5.0	2.1	9.0	0.1	-2.7	-3.8
		%					
Investment to GDP ratio (at current prices)							
Fixed investment		24.1	23.9	23.9	22.9	23.1	23.3
Private		19.9	19.6	19.0	18.2	18.7	19.1
Public		4.2	4.3	4.8	4.7	4.5	4.2

[1]Includes cultivated assets and intellectual property products

1.3.4 Public investment

Public investments account for about 20% of all investments, with local government accounting for more than half of the total and central government a little less than a half. The share of social security funds is very small. Close to 30% of public investments are civil engineering investments, with other construction investments accounting for the same percentage of the total. Research and development investments account for slightly over 25% and investments in machinery and equipment slightly over 10% of the total.

During the past few years, public investments have remained at a high level, over 4% in proportion to GDP. They are expected to continue to grow in 2020.

The stimulation programmes launched by Prime Minister Marin's Government and the measures foreseen in the government programme will mean a substantial increase in investments in 2020. Central government investments will increase, in particular, as a result of additional spending on transport corridors as well as research, development and innovation activities. Local government investments will also increase in 2020 due to social and healthcare construction and investments in municipal infrastructure. The brisk growth of public investments will come to halt in 2021 but public investments will still remain at a high level.

In the last few years of the forecast period, public investments are expected to develop slowly. In 2020, the fall in local government investments will be reflected in the decrease of all public investments. The sustained increase in local investments will level off, mainly due to the slowdown of hospital construction.

1.4 Domestic production

1.4.1 Total output

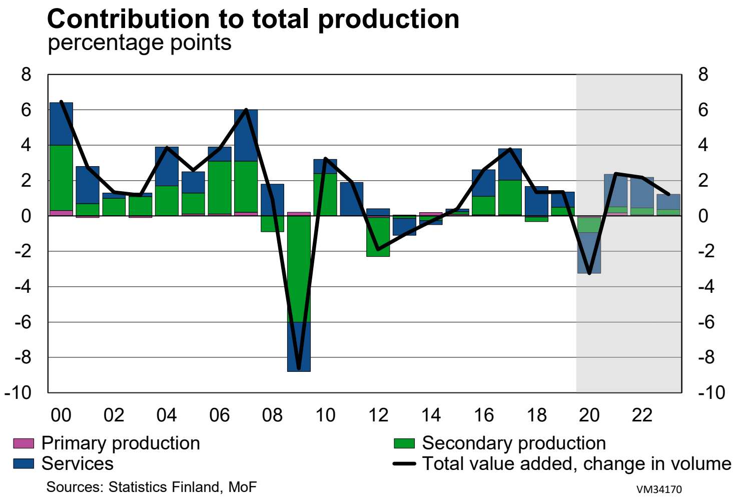
Economic recovery will not take off until 2021

The improvement in the pandemic situation after the first wave manifested itself in the recovery of economic activity in the third quarter. Industry, in particular, put in a good performance despite its own low-key expectations. Services, too, developed a little more favourably than foreseen. Fiscal stimulation has supported economic activity and dispelled doubts about the future. The pandemic situation is also getting worse in Finland towards the end of the last quarter of 2020. As a result, Finland's GDP is predicted to contract further by the end of the year. Overall, GDP for 2020 is expected to fall by 3.3% year-on-year.

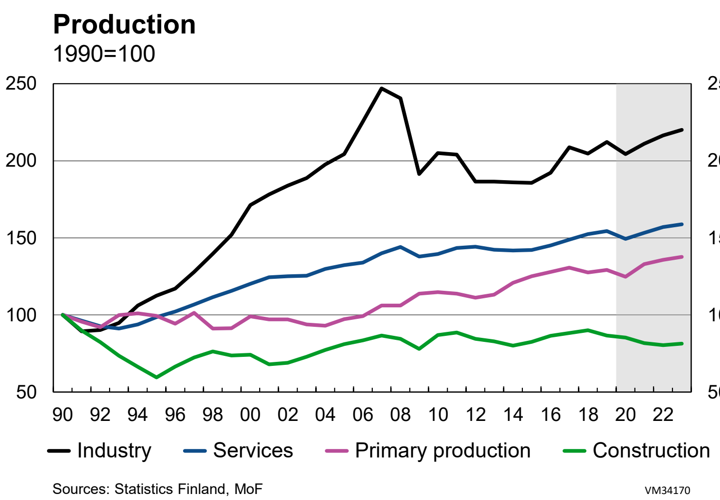
In 2021, economic growth will set first in industry and then in services. The recovery of industry has been aided by the quick revival of world trade. The forecast predicts that the most intensive period of growth will take place in the third quarter of 2021 because that is when demand for accommodation, catering and transport services is expected to pick up sharply. Growth in 2021 will be adversely affected by falling construction activity. Construction will slowly return to normal demand from the earlier heights. Moreover, many civil engineering projects will be gradually completed in 2021. In 2021, the economy will grow by a total of 2.5%.

As domestic growth is expected to be very fast in 2021, it will spill over to 2022. The substantial growth in export demand over the next few years will keep the wheels rolling in the Finnish industry. In 2022, domestic and international demand will sustain economic growth at 2%. In 2023, the economy will resume the long-term average growth rate at the same time as the output gap is closing.

Services, which account for 70% of Finland's economy, will have the biggest effect, first on the contraction of the economy in 2020 and subsequent growth later on.

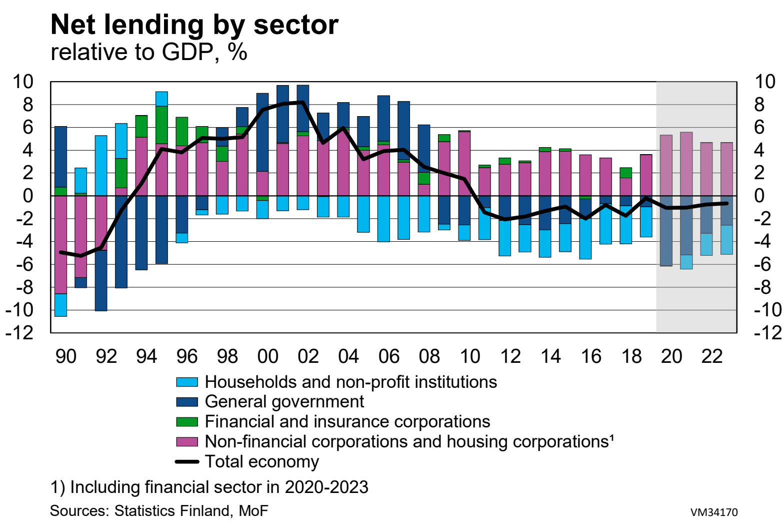


Primary production will decrease considerably in 2020 because the cereal harvest will fall below the average (-20%) due to the dry early summer. Moreover, demand for forest industry products declined in early 2020, and the situation was aggravated by strikes in the forest industry. Agricultural production will reach regular levels if and when the cereal harvest in 2021 proves normal as expected. Logging is also assumed to increase in 2021, including total output by the forestry. For primary production in 2022 and 2023, the forecast predicts close- to-normal average annual growth.



Productivity per hours worked will fall by 0.7% in 2020. Calculated per those employed, productivity will decrease by 1.8%. In 2021, productivity per hours worked will improve by 2.1%, after which annual growth will slow down to an average rate of 1% in 2022 and 2023. The operating surplus is expected to fall by a little less than 6% in 2020 but increase by more or less the same amount in 2021 and 2022. Finland's unit labour cost will increase by about 1.3% during 2020–2023.

Extensive public sector borrowing has cushioned the blow to the private sector. The increased caution exercised by households is visible in the improvement of their net financial position.



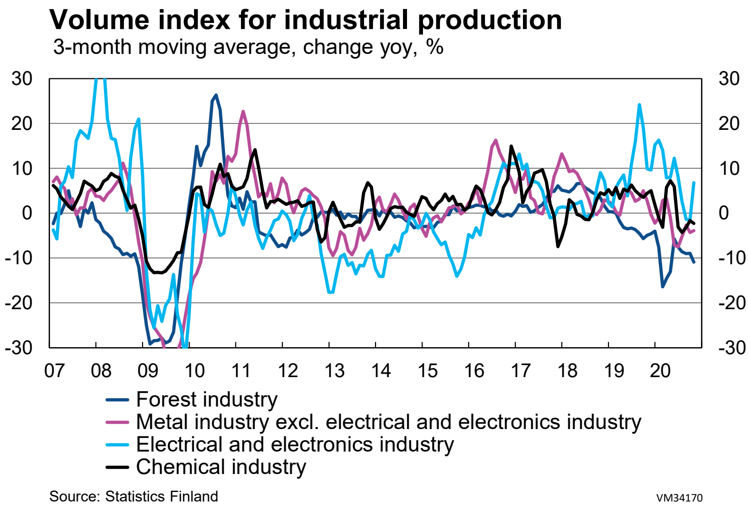
1.4.2 Secondary production

Quick recovery of world trade creates demand in industry

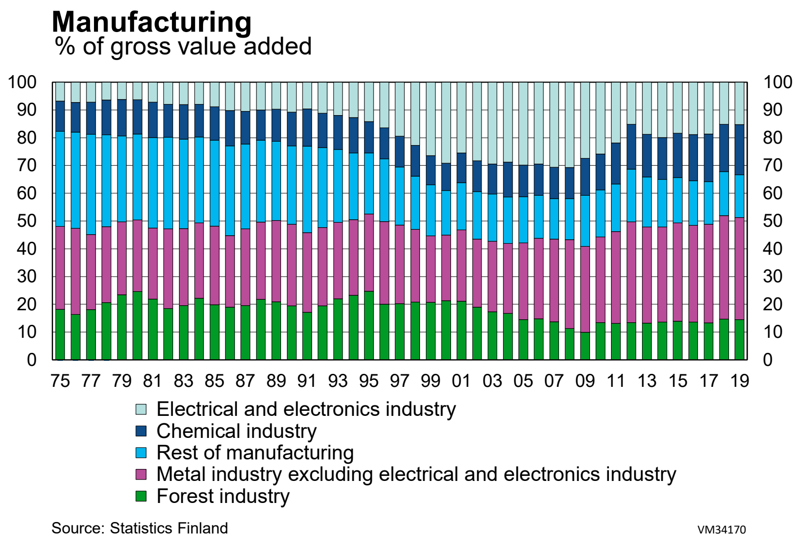
The contraction of industrial production ended in the third quarter of 2020. This came as a surprise to both industry and forecasters. Even though the value of new orders had decreased by about 13% during January–October, this was not reflected in the production figures. The volume of production is estimated to fall by less than 4% in 2020.

Growth is predicted to set in at the beginning of 2020 when international trade expands and exports pick up. Industrial production is expected to grow at a brisk rate in 2021. Annual growth will be 3.3%. Growth is predicted to continue at a sound level up to 2023.

The forest industry has been adversely affected by a sharp, more than 20% decline in the demand for paper due to the COVID-19 pandemic as well as the strikes organised early this year. For the chemicals industry, the early part of the year was tough, but a fair amount of growth was achieved in the third quarter. The metals industry performed poorly in early 2020; slight growth in production was, however, discernible in the third quarter. An exception to this is the electric and electronics industry which has been growing for three quarters in 2020.



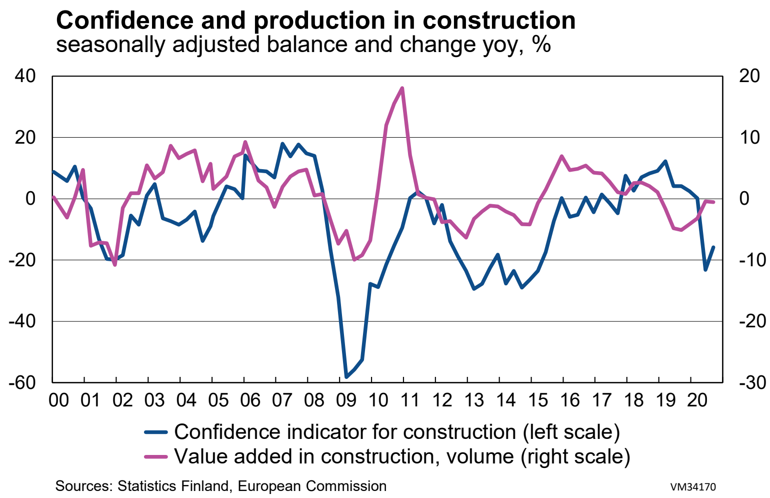
The expectations of the sectors themselves are bleak. The metals and electronics industries expect production volumes to decline further in the first quarter of 2021. In contrast, the forest and chemicals industries hope to be on the growth path by then. The fall in new orders has been the sharpest in the forest industry. A further dive was experienced in September 2020 when the level was already low. As the following diagram shows, the metals industry generates most of the industrial value added. Demand for metal products is uncertain because of the lag in investments. The order books of the chemicals industry are swelling. It is the second largest industrial sector in Finland, half of the size of the metals industry.



Number of building starts is returning to normal and construction will decrease in the next few years

Recent statistics have shed new light on construction in early 2020. Growth has been replaced by contraction. Although the COVID-19 pandemic has not had a major impact on construction, it has postponed repair construction and delayed and deferred projects. The industry does not expect much from the next winter. As the diagram shows, production volumes and expectations do not meet. Possibly, the pessimistic mood prevailing in the construction sector may have coloured the responses. Long-term average expectations are slightly negative. Admittedly, the number of planning permissions has remained low.

The number of residential building starts has been fairly high. A total of 30,500 new housing units had been started by the end of September, and the forecast for the whole year is 36,000. Economic stimuli have also been provided for housing production in 2020. Extremely low interest rates continue to sustain demand for owner-occupied dwellings and real estate investors in the Finnish housing market. The doubling of rental housing production in the Helsinki area and its continued upward trend will gradually dampen demand for housing. The number of residential construction starts is predicted to fall to 32,000 units in 2021 and further to 31,000 in 2022.



Industrial, commercial and office construction will continue to sustain the industry in 2020 because a large number of the projects launched take 18 months to complete. In 2021, there will be clearly fewer stars because the numbers of planning permissions are falling sharply. The occupancy rates of offices and commercial properties have decreased as a result of the COVID-19 pandemic. This effect may be long-lasting as companies and public sector employers have come to realise the efficiency gains offered by telecommuting and its savings potential in property costs.

In civil engineering, turnover and volume have been growing at double-digit rates in 2020, propelled by a general increase in appropriations for route maintenance and stimulation programmes.

Construction is expected to decrease slightly in 2020. In 2021, the volumes will decline clearly because the number of planning permissions has fallen substantially. In particular, the exceptionally long period of intensive growth in service construction appears to be fading into history. Growth in repair construction will accelerate in 2021 when pent-up demand is released. Construction will no longer contract in 2022, but annual growth will still fall short of the figures for 2021.

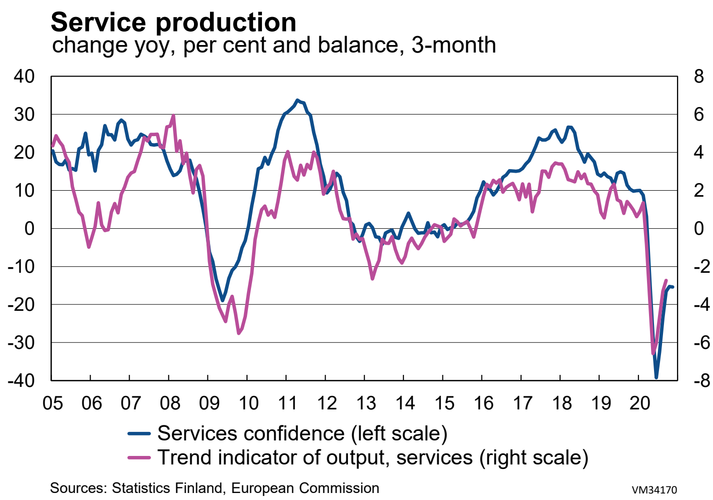
1.4.3 Services

Service production will increase when the pandemic ends

Service production picked up in the third quarter of 2020 in response to domestic demand as service exports continued to decline further in the third quarter. Towards the end of the year, service production declined again as the number of coronavirus infections rose sharply. Public services started expanding in the third quarter, even if they still remain in the red annually. It appears that part of the growth in service production will occur in 2021 because in healthcare, for example, treatments have been postponed to a later date.

Of the service sectors, the accommodation and catering industries have suffered most from the COVID-19 pandemic. Financing and insurance activities have been doing well and the prospects for the rest of the year remain positive. Similarly, information and communication services have put in a good performance despite the current situation and the expectations for the rest of the year are bright. Catering services were cut back in the last quarter because of the shortened opening hours.

Retail trade has outperformed other service sectors and specialty stores. As far Christmas sales are concerned, its prospects are favourable. Business indicators show that in October the service sector as a whole expected sales to fall in the last quarter and also remain at this level during the first quarter of 2021.



Service production is expected to contract by 3.3% in 2020. The projected growth for 2021 is 2.6%, after which it will gradually level off and revert to the average growth rate in 2022 and 2023.

Table 10. Production by industry

	2019	2018	2019	2020**	2021**	2022**	2023**
	share, %[1]	change in volume, %					
Industry	20.5	-2.0	3.7	-3.8	3.3	2.6	1.7
Construction	7.5	2.1	-3.9	-1.1	-4.3	-1.4	1.3
Agriculture and forestry	2.7	-2.3	1.2	-3.8	6.6	2.2	1.4
Industry and construction	28.0	-0.9	1.6	-3.1	1.2	1.5	1.5
Services	69.4	2.4	1.2	-3.3	2.6	2.5	1.1
Total production at basic prices	100.0	1.3	1.3	-3.2	2.4	2.2	1.2
GDP at market prices		1.5	1.1	-3.3	2.5	2.0	1.4
Labour productivity in the whole economy		-1.0	0.2	-0.7	2.1	1.4	0.6

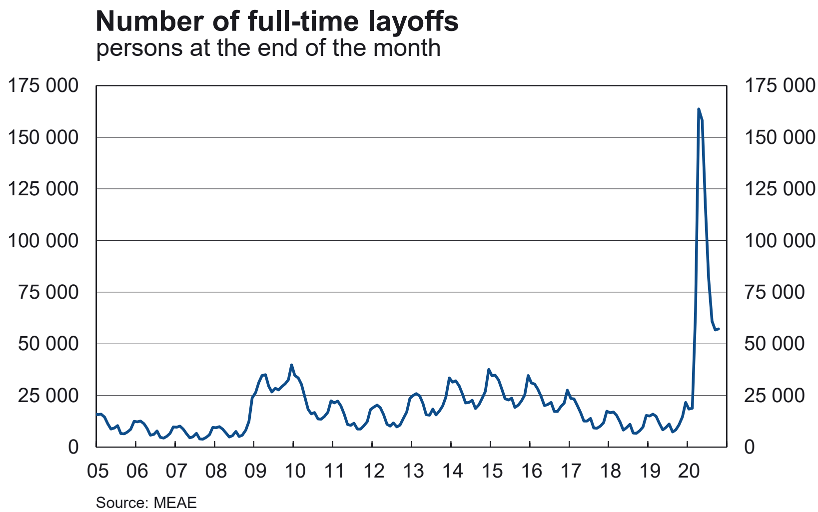
1) Share of total value added at current prices.

1.5 Labour force

Employment will fall and unemployment increase initially

There has been a clear decline in employment in 2020. In October, the trend of the employment rate stood at 71.7%, one percentage point lower than in January. In January–October, the number of those employed was down 37,000 year-on-year. However, the trend has improved since May. The number of those working continuously on a full-time basis was higher in 2020 than 2019, but the number of those employed for a fixed term or on a part-time basis was clearly lower. At the same time, the number of under-employed increased considerably. The amount of work (hours worked) has decreased almost twice as much as the number of those employed, or 2.6%. The decline in employment has been the sharpest in trade, social welfare as well as accommodation and catering services. In the energy supply sector and certain business services, employment has improved.

Due to the weak and uncertain economy, the labour market seems to offer few job opportunities because the number of those outside the labour market has been growing this year. Hidden unemployment was also more common than the year before. In early 2020, demand for labour decreased and the reversal of the trend



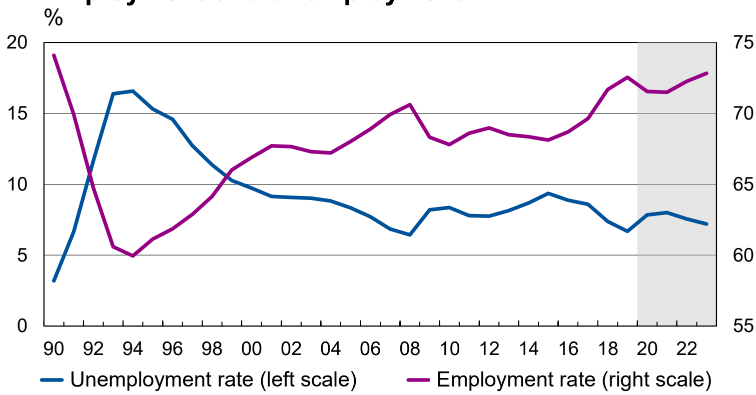
has been slow and uncertain. However, job opportunities are still available. The number of vacancies in the third quarter was 43,000, only slightly less than in 2019. The employment expectations of Finnish companies absolutely collapsed in April, particularly in the service trades. The expectations improved in August but turned again for the worse in the key industries in the autumn.

Aside from redundancies, companies have sought savings in labour costs through lay-offs. The number of those laid off decreased quickly in the summer from the record levels, but the trend was again reversed in the autumn. While part of this increase can be explained by seasonal fluctuations, employer-employee talks have become more common in the course of the autumn.

The new restrictions introduced in response to the growing number of infections will further reduce the demand for and supply of services in particular and result in another dip in unemployment. This year employment will decline by an average of 1.5% and the employment rate will fall to around 71.5%.

When the pandemic abates, steps can be taken to lift economic restrictions. This will, however, take a long time, and so the economy will not recover substantially until later in the year. Hence, the demand for labour will pick up slowly. The trend will intensify in 2022 and 2023, especially in the service sectors. The number of those employed is predicted to continue to decline slightly in 2021 but the trend is believed to reverse in 2022. The number of the employed will not reach the 2019 level until 2023, and the employment rate will rise to about 73% in 2023.

Employment and unemployment



Unemployment rate = Unemployed / Labour force (15–74 yrs)
Employment rate = Employed / Population of working age (15–64 yrs)

Sources: Statistics Finland, MoF VM34170

The internationally comparable number of the unemployed used by Statistics Finland has increased clearly less than the number of unemployed job-seekers registered by the Ministry of Economic Affairs and Employment. However, even the labour force survey conducted by Statistics Finland shows that the number of the hidden unemployed outside the labour market interested in finding work has increased very quickly, just like the number of those under-employed who would like to work longer hours. Aside from cyclical unemployment, the register compiled by the Ministry of Economic Affairs indicates that structural unemployment has increased in all categories except for those who transfer from employment services to unemployment.

The trend in unemployment figures is slightly descending, but it may well be reversed by the second wave of the pandemic. Redundancies and lay-offs will become more common as a result of increased uncertainty and restrictions. Owing to the fall in employment and the large number of those laid off, the number of the unemployed will increase by about one sixth and the unemployment rate reach almost 8% in 2020. Due to the slow recovery of the economy and the decrease in employment, unemployment rate will not fall in 2021 but increase to 8%. The biggest fall in unemployment will take place in 2022 and 2023 when the economy recovers from the pandemic and the restrictions are lifted. In 2023, the unemployment rate will fall to little over 7%, which is still slightly higher than the level of structural unemployment estimated using the method developed by the Commission.

Table 11. Labour market

	2018	2019	2020**	2021**	2022**	2023**
	annual average, 1,000 persons					
Population of working age (15–74 yrs)	4124	4128	4131	4123	4111	4100
change	10	4	3	-8	-12	-11
Population of working age (15–64 yrs)	3439	3428	3423	3416	3410	3408
change	-12	-11	-5	-7	-6	-2
Employed (15–74 yrs)	2538	2566	2527	2519	2542	2560
of which 15–64 yrs	2465	2487	2449	2442	2464	2482
Unemployed (15–74 yrs)	202	184	215	219	208	199
	%					
Employment rate (15–64 yrs)	71.7	72.5	71.5	71.5	72.3	72.8
Unemployment rate (15–74 yrs)	7.4	6.7	7.8	8.0	7.6	7.2
	1,000 persons per annum					
Immigration, net	16	18	17	17	17	17

1.6 Incomes, costs and prices

1.6.1 Wages and salaries

Earnings will increase but the wagebill decrease due to higher unemployment

The rate of increase in nominal wages and salaries slowed down in the first three quarters of 2020 to 1.7% from 2.2% in 2019. The slower rate was due to smaller pay increases specified in collective agreements because wage drifts increased. The increase in earnings was slightly faster in the public than the private sector, which was partly due to the expiry of holiday pay cuts in the summer of 2019.

A significant number of new collective agreements were signed in the private and public sector in 2020. The collective agreements for food industry employees, senior officers in the merchant marine in overseas service, air traffic controllers and road transport clerical employees will expire in spring 2021. On average, the agreements will increase nominal wages and salaries by less than 1.5% in 2020. Despite the economic recession, wage drift appears to increase relative to 2019, and nominal earnings will grow by 1.7%.

Most likely, revived economic activity and improved employment will increase wage drift as of 2021. Additionally, a number of private and public sector agreements foresee pay increases exceeding the 2020 level by 0.5%. Consequently, the rate of increase in agreement-based pay and nominal earnings would be 2.5% in 2021. Some collective agreements made in 2020 extend to early 2023. While the pay increase to be granted under these agreements will be determined at a later date, the forecast assumes that the increase in earnings in 2022 and 2023 will be influenced by the projected decelerating growth in labour productivity. Hence, the foreseen pay increases would not exceed those of 2021, so that earnings would grow by 2% annually in 2022 and 2023.

Aside from nominal earnings, the wagebill is affected by employment trends. Since employment will fall substantially in 2020, the wagebill will decrease by 0.5%. With increased earnings and improved employment, the wagebill is expected to grow at an average annual rate of about 2.5% in 2021–2023.

Table 12. **Index of wage and salary earnings and labour costs per unit of output**

	2018	2019	2020**	2021**	2022**	2023**
	change, %					
Index of negotiated wage rates	1.2	2.0	1.2	2.0	1.4	1.4
Wage drift, etc.	0.5	0.1	0.5	0.5	0.6	0.6
Index of wage and salary earnings	**1.7**	**2.1**	**1.7**	**2.5**	**2.0**	**2.0**
Real earnings[1]	0.6	1.1	1.4	1.4	0.6	0.4
Average earnings[2]	2.2	1.8	2.2	2.2	2.1	2.1
Labour costs per unit of output whole economy[3]	2.5	1.6	1.1	1.5	1.1	1.4

1) The index of wage and salary earnings divided by the consumer price index.
2) Computed by dividing the national wage bill by the number of hours worked by wage and salary earners. The figures are affected by structural changes in the economy.
3) Compensation of employees divided by gross value added in volume at basic prices.

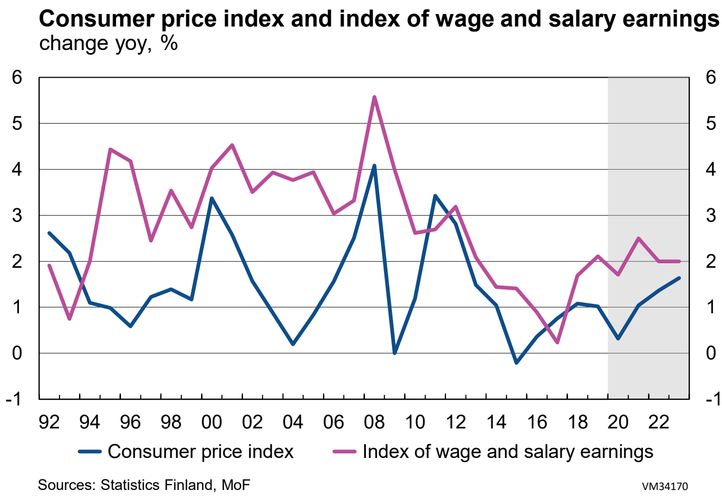
1.6.2 Consumer prices

The slightly positive annual change in the consumer price index has continued during the autumn of 2020. The rate of increase in the price of food, especially fresh food, has slowed down. However, the price of food remains the main driver of inflation because the prices of other items have increased more slowly.

The fall in the price of goods continued in summer 2020 after a short-lived pause. The fall in energy prices is still reflected in consumer prices, even though the effect has been wearing off since the spring.

Based on the 2020 national consumer price index, the inflation rate is estimated to reach 0.3%. The slow increase in the price of oil will keep energy prices negative despite increased taxes. Although the increase in the price of services is slowing down, it is enough to maintain inflation. The baseline inflation will also remain positive.

Energy prices started driving inflation after the baseline effect ceased to operate in the spring of 2021, even though the movement in the price of oil is expected to remain modest. Inflation will accelerate in 2021 only slightly and is expected to reach 1.0% measured by the national consumer price index. Weak demand and widespread uncertainty keeps inflation rate modest in early 2021.



Consumer prices will also start rising moderately once economic growth returns to normal.

Pay increases are transmitted to the price of services and subsequently to consumer prices. In 2022 and 2023, the national consumer price index is expected to rise by 1.2% and 1.4%, respectively.

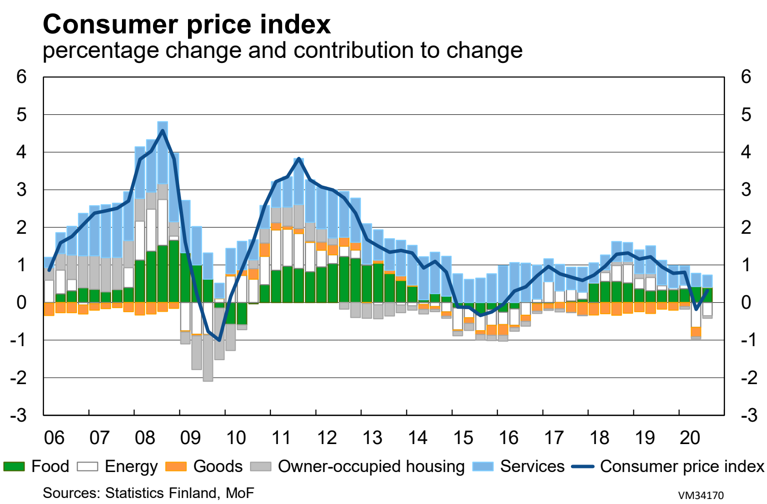


Table 13. Price indices

	2018	2019	2020**	2021**	2022**	2023**
	change, %					
Export prices[1]	4.2	-0.3	-4.7	1.8	1.9	1.6
Import prices[1]	3.5	0.4	-5.1	1.9	2.1	1.6
Consumer price index	1.1	1.0	0.3	1.0	1.4	1.6
Harmonised index of consumer prices	1.2	1.1	0.4	1.1	1.5	1.8
Basic price index for domestic supply, including taxes	4.7	1.0	-3.7	1.1	2.0	2.2
Building cost index	2.2	1.0	-0.2	1.4	1.9	2.1

[1] As calculated in the National Accounts

2 Public finances

2.1 General government finances

The deficit of general government finances will grow substantially in 2020 because of the weak business cycle conditions and the support measures taken in response to the COVID-19 pandemic. While the economy will recover in 2021, public finances will be left in a more feeble state than before the onset of the pandemic. The economic growth foreseen for the next few years will not be enough to restore general government finances to pre-crisis levels; instead, a clear deficit will persist. There is a structural imbalance between revenue and expenditure.

Public debt has grown fast during 2020. By the end of the year, the debt ratio will increase by almost 10 percentage points to nearly 70%. In the following years, the growth of the debt ratio will slow down, but it will nevertheless continue to increase to 75% by the mid-2020s. The deficits in central and local government finances will increase the debt ratio even though debt servicing costs remain record-low. The public debt ratio will exceed the level prevailing before the crisis and stay high.

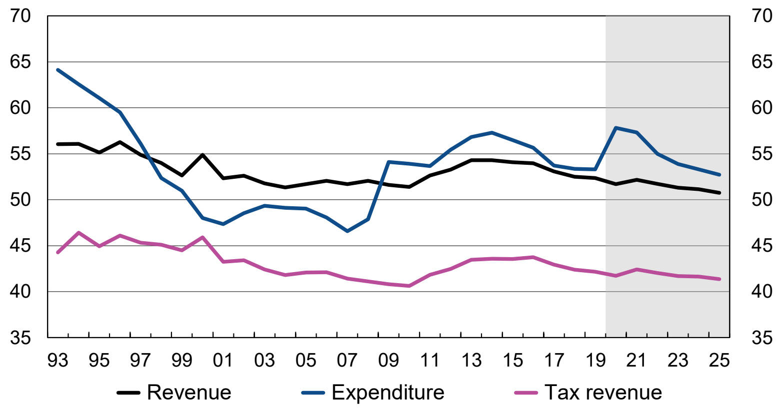
Most of the cost of the support measures launched in response to the COVID-19 pandemic is borne by central government. Fiscal policy has been highly expansionary in 2020 and will support economic activity also in 2021. A more detailed description of the fiscal policy response is provided in the box on page 71. As of next year, the deficit of central government finances will start diminishing as the economy grows and most of the support programmes are phased out.

For local government, the situation will be temporarily alleviated in 2020 and 2021 thanks to the massive state subsidies granted in response to the pandemic. The local government financial position is burdened by the increased need for social and healthcare services due to the ageing population and increased expenditure. The structure of the public sector will undergo a change in 2023 when responsibility for the organisation of social welfare and healthcare as well as rescue services is assumed by[1] the wellbeing services regions. This will ease the financial pressures on municipalities.

The surplus of employment pension institutions will shrink considerably in 2020 when employment pension insurance contributions are temporarily reduced and revenues decrease because of lower employment. The surplus will also remain modest in the next few years as pension expenditure continues to increase and the extremely low interest rates slow down revenue growth.

The financial position of other social security funds will be undermined by lay-offs, rising unemployment and the temporary extensions to unemployment security. In 2021, the situation will be alleviated by the foreseen fall in the number of those laid off and the increase in unemployment insurance contributions.

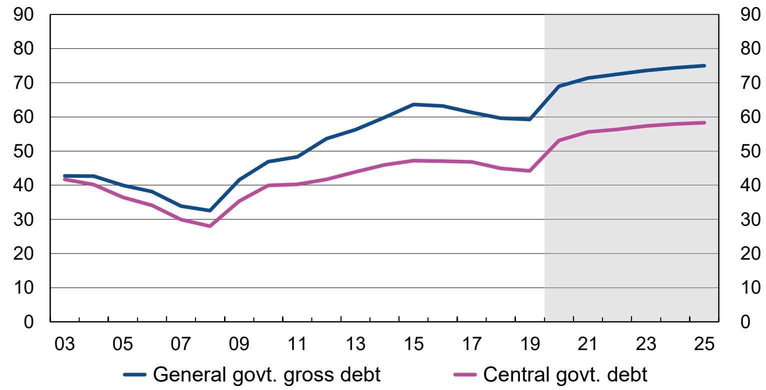
General government revenue, tax revenue and expenditure
relative to GDP, %



Sources: Statistics Finland, MoF

1 This transition is not yet taken into account in the present forecast but it will be included in the Spring 2021 forecast

General government debt
relative to GDP, %



Sources: Statistics Finland, MoF
VM34098

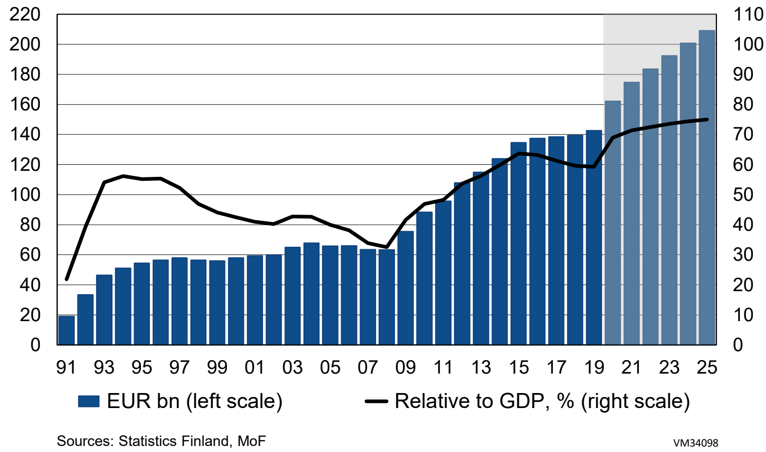
Currently, the most significant risks facing general government finances are related to the overall development of the economy. Any new waves of the pandemic, increased general uncertainty and potentially retightened lockdown measures may retard economic recovery and weaken general government finances until a sufficiently high percentage of the population is vaccinated. At the same time, the use of the 2020 and 2021 budget appropriations involves a degree of uncertainty. Additionally, contingent liabilities and, in particular, the marked increase in guarantees poses a risk to general government finances. Another factor increasing exposure is that the guarantees concentrate in certain sectors and companies. Guarantee authorisations have also been increased in 2020 as part of the financial support provided for companies. If the guarantees are triggered on a large scale, it would increase public expenditure and further raise the debt ratio.

Table 14. General government finance[1)]

	2018	2019	2020**	2021**	2022**	2023**
	EUR billion					
Current taxes	37.4	38.4	37.3	39.2	40.3	41.4
Taxes on production and imports	33.1	33.7	32.5	33.8	34.5	35.1
Social security contributions	27.9	28.6	27.5	29.9	30.7	31.6
Taxes and contributions, total[2]	99.1	101.4	98.1	103.8	106.4	109.0
Other revenue[3]	24.3	25.3	24.3	24.8	25.4	26.0
of which interest receipts	1.7	1.6	1.4	1.4	1.5	1.5
Total revenue	**122.7**	**125.9**	**121.6**	**127.7**	**130.9**	**134.1**
Consumption expenditure	53.4	55.3	57.4	61.2	61.3	62.4
Subsidies	2.7	2.9	4.5	3.9	2.9	2.8
Social security benefits and allowances	43.0	43.8	46.8	47.3	47.9	48.9
Other current transfers	5.6	6.0	6.3	6.5	6.3	6.4
Subsidies and current transfers, total	51.4	52.6	57.6	57.7	57.1	58.1
Capital expenditure[4]	10.2	10.7	11.8	12.5	11.9	11.6
Other expenditure	9.7	9.6	9.1	8.8	8.8	8.7
of which interest expenses	2.1	1.9	1.7	1.2	1.1	0.9
Total expenditure	**124.7**	**128.2**	**135.9**	**140.3**	**139.2**	**140.8**
Net lending (+) / net borrowing (-)	**-2.0**	**-2.3**	**-14.4**	**-12.6**	**-8.3**	**-6.7**
Central government	-2.9	-2.9	-14.3	-12.0	-7.1	-6.2
Local government	-2.0	-2.7	0.0	-1.4	-2.4	-2.2
Employment pension schemes	2.3	2.7	0.4	1.1	1.3	1.4
Other social security funds	0.6	0.6	-0.5	-0.3	-0.1	0.2
Primary balance[5]	0.1	-0.4	-12.6	-11.4	-7.2	-5.8

1) As calculated in the National Accounts
2) Incl. capital taxes
3) Incl. capital transfers and consumption of fixed capital
4) Gross fixed capital formation and capital transfers
5) Net lending excluding gross interest expenses

General government debt



Sources: Statistics Finland, MoF

Table 15. Main economic indicators in general government

	2018	2019	2020**	2021**	2022**	2023**
	relative to GDP, %					
Taxes and social security contributions	42.4	42.2	41.7	42.4	42.0	41.7
General government expenditure[1]	53.4	53.3	57.8	57.3	55.0	53.9
Net lending	-0.9	-1.0	-6.1	-5.2	-3.3	-2.6
Central government	-1.2	-1.2	-6.1	-4.9	-2.8	-2.4
Local government	-0.9	-1.1	0.0	-0.6	-1.0	-0.8
Employment pension institutions	1.0	1.1	0.2	0.4	0.5	0.5
Other social security funds	0.2	0.3	-0.2	-0.1	-0.0	0.1
Primary balance[2]	0.0	-0.2	-5.4	-4.7	-2.8	-2.2
General government debt	59.6	59.3	69.0	71.4	72.5	73.6
Central government debt	44.9	44.2	53.1	55.6	56.3	57.3
General government employment, 1,000 persons	632	647	652	660	662	658
Central government	135	136	138	138	138	138
Local government	484	497	501	509	511	507
Social security funds	13	13	13	13	13	13

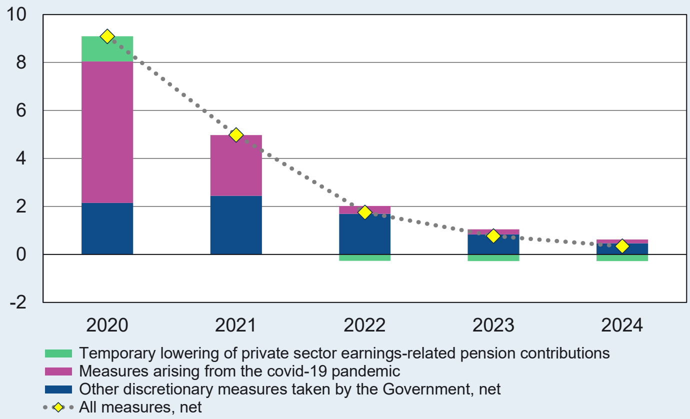
1) EU-harmonized definition
2) Net lending excluding gross interest expenses

FISCAL STANCE

The public sector supports economic activity during the COVID-19 pandemic through both the measures launched by the Government and the operation of the automatic stabilisers. The deficit in general government finances will in 2020 grow from EUR 2.3 to EUR 14.4 billion and remain at EUR 12.6 billion in 2021.

The following diagram illustrates the scale of Government actions affecting public revenue and expenditure cumulatively by budget year. Serving as the benchmark is the 2019 Technical General Government Fiscal Plan. Decisions affecting the financial position as reflected in the national accounts at the general government level[1] were made to the tune of EUR 9 billion for 2020 and EUR 5 billion for 2021.

Discretionary measures taken by the Government
EUR bn

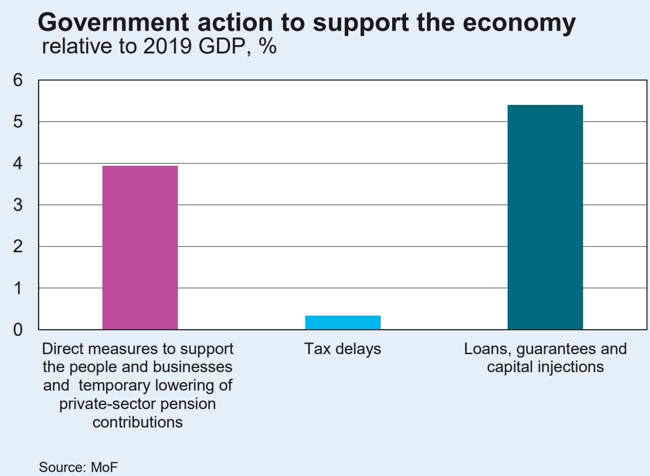


Source: MoF

All the discretionary measures, such as deferred payments and government loans, guarantees and capital infusions, do not affect the financial position in national accounts directly and are, therefore, not shown in the above diagram. The following diagram provides an overview of all the measures taken in response to the COVID-19 pandemic and the related recession and included in all the 2020 supplementary budgets, the 2021 budget proposal and the amendment to the supplementary budget proposal. A more detailed description of the measures is provided in the 2020 spring, summer and autumn economic surveys. For comparison, see the Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic[2] maintained by IMF.

1 From the standpoint of on-budget finances, the measures are even more extensive because the central government has provided financial support for other public sector entities, notably municipalities.

2 https://www.imf.org/en/Topics/imf-and-covid19/Fiscal-Policies-Database-in-Response-to-COVID-19



The deferred tax payments reported in the diagram are based on actual data upon expiry of the application period. Originally, deferred payments were assumed to amount to 0.8% of GDP. Guarantees are shown as a sum total of all authorisations, but few of them have been invoked so far.

Year-on-year changes in fiscal policy measures can be assessed in various ways. The following diagram illustrates the annual change in fiscal policy in three ways: the change in structural balance by making use of potential output calculations in which the cyclical effect on the state of general government finances is eliminated; th bottom-up indicator summing up individual measures by budget year; and the Discretionary Fiscal Effort (DEF) indicator combining these two approaches[3] .

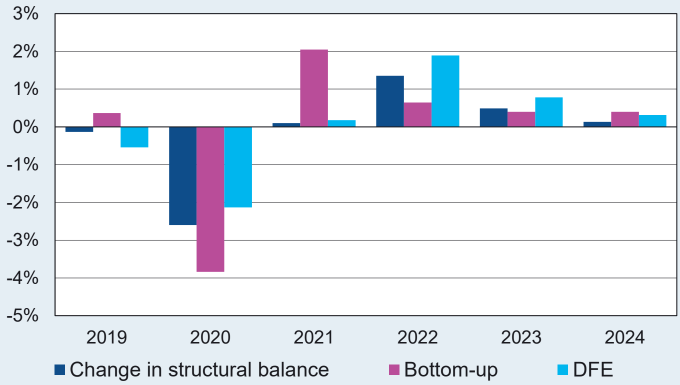
All the indicators show that the fiscal policy response is clearly expansionary in 2020. This is only natural because the government has made decisions on massive support measures to help citizens and companies in response to the COVID-19 pandemic and the subsequent recession. Additionally, the measures foreseen in the government programme have stimulated the economy in 2020.

The indicators in the diagram show that in 2021 fiscal policy will be contractionary or more or less neutral, even though the number of cost-increasing measures will continue to remain much higher than expected by the Government at the beginning of its term. A year-on-year analysis shows that fiscal policy will automatically become contractionary when many of the pandemic-related one-off measures expire in 2021 when the crisis eases.

3 A more detailed description of the indicators and their characteristics is provided in Ahola, Pääkkönen, Tamminen 2017 – Finanssipolitiikan päätösperäisyyden arvioiminen – vaihtoehtoisten mittareiden esittely (Assessing the discretionary fiscal effort – presenting alternative indicators)

Also, there are differences in the scale of the impact presented in the assessments based on the individual indicators. One explanation for this is that the timing of all measures affecting general government finances cannot be directly deduced from budgeted revenue and expenditure because appropriations covering several years may also be drawn down after the budget year. Exceptions have been made to budgeted appropriations or disbursements in the forecast for general government finances – and, hence, in the projected change in the structural balance based on the forecast and the DFE indicator – if and when the monitoring data suggests that the appropriations will not be fully used in the budget year. Moreover, the pandemic situation has resulted in a fall in the use of public services and hence offered savings in general government finances in 2020. However, the service and healthcare backlog created during the pandemic will pile up spending pressures once the pandemic starts to ease. While this is duly taken into account in the forecast for general government finances, it does not show in the bottom-up indicator.

Fiscal stance measured by different indicators



Sources: Statistics Finland, MoF

The financing available under the EU recovery instrument (Next Generation EU) will also have an expansionary effect over the next few years. Since Finland's Sustainable Growth Programme will be mostly funded by subsidies under the recovery instrument, it is not expected to have a major impact on the general government financial balance during 2021–2023. Finland's recovery and resilience plan, which is designed for seeking funding for investments and reforms under the largest single component of the instrument, the Recovery and Resilience Facility, will be prepared in winter 2021 and submitted to the EU no later than April 2021. Although the Government has already defined the general priorities of the plan, the application has not been included in the forecast for general government finances in the absence of details.

2.2 Central government

The five-year long improvement in central government finances came to an end in 2019. The intense contraction of the economy in 2020 has undermined government finances as a result of the operation of automatic stabilisers and reduced revenues. At the same time, discretionary spending increases have weakened the central government financial position substantially. Central government finances are expected to show a deficit of EUR 14.3 billion in 2020, more than 6% relative to GDP.

Discretionary expenditure has been increased by the expansionary fiscal policy pursued by the Government. During 2020, Prime Minister Marin's government has presented seven supplementary budgets in order to improve social security on a temporary basis, support companies and stimulate the economy. Additionally, decisions have been made in connection with supplementary budgets to grant government aid to municipalities and launch new infrastructure projects.

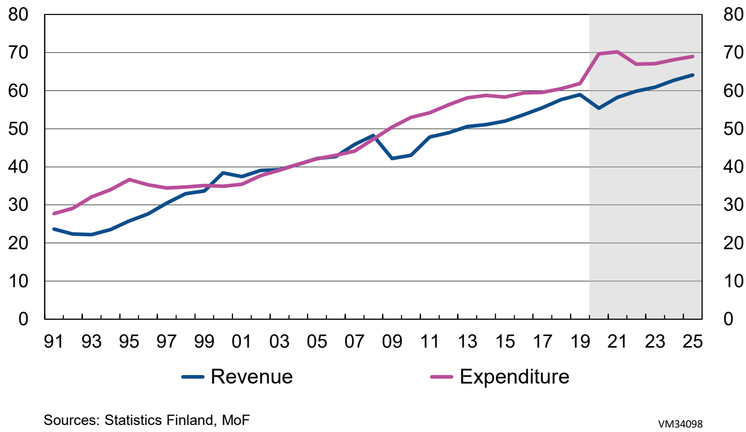
In 2020, government expenditure will increase by EUR 7.8 billion relative to 2019. Most of the additional spending will consist of corporate subsidies and income transfers to other public sector entities. Current expenditure is increased, in particular, by the direct additional cost of procuring materials, supplies and protective gear necessitated by the COVID-19 pandemic as well as by additional spending on education. Investment expenditure will increase as a result of the increase of the financing of the basic transport infrastructure management as of 2020 and the new transport infrastructure projects decided in connection with supplementary budgets.

Aside from increased expenditure, the general government finances are undermined by the fall in tax revenues due to the contraction of the economy. In 2020, the tax revenues, both direct and indirect, raised by central government fell substantially relative to 2019.

In 2021, the central government deficit will shrink considerably with a sharp increase in revenue, boosted by rising direct taxes. In contrast, expenditure will not decrease in 2021 because most of the increases to subsidies and current expenditure granted in 2020 will be disbursed in 2021. These include the procurement of the vaccines and protective and testing equipment necessitated by the COVID-19 pandemic. Additionally, part of the subsidies decided in 2020 will be paid out in 2021; for instance, the second round of applications for business subsidies will commence in December 2020.

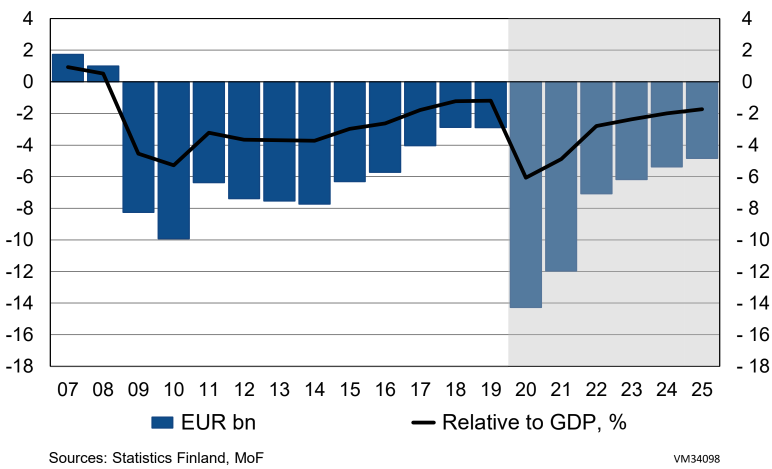
The deficit will shrink substantially as a result of decreased expenditure in 2021 when the additional spending due to COVID-19 expires. In 2023, the deficit will be reduced slightly as revenue grow will exceed expenditure. Although the deficit will decrease gradually, the central government financial position appears to fall short of the pre-COVID level.

Central government revenue and expenditure
EUR bn



Sources: Statistics Finland, MoF

Central government financial balance



Sources: Statistics Finland, MoF

Table 16. Central government[1]

	2018	2019	2020**	2021**	2022**	2023**
	EUR billion					
Current taxes	14.9	15.2	13.0	14.2	15.2	15.6
Taxes on production and imports	33.1	33.7	32.5	33.8	34.5	35.1
Social security contributions	0.0	0.0	0.0	0.0	0.0	0.0
Taxes and social security contributions, total[2]	48.7	49.7	46.3	49.0	50.6	51.6
Other revenue[3]	9.1	9.5	9.2	9.2	9.3	9.3
of which interest receipts	0.3	0.2	0.3	0.3	0.3	0.2
Total revenue	**57.8**	**59.1**	**55.4**	**58.2**	**59.9**	**60.9**
Consumption expenditure	14.0	14.6	14.8	16.1	16.1	16.2
Subsidies and current transfers, total	40.0	40.8	47.7	46.9	44.3	44.6
to general government	28.2	28.7	33.5	33.1	31.7	32.0
Interest expenses	1.9	1.8	1.6	1.1	1.0	0.8
Capital expenditure[4]	4.7	4.9	5.6	6.1	5.6	5.5
Total expenditure	**60.7**	**62.0**	**69.7**	**70.2**	**67.0**	**67.1**
Net lending (+) / net borrowing (-)	**-2.9**	**-2.9**	**-14.3**	**-12.0**	**-7.1**	**-6.2**
Primary balance[5]	-0.9	-1.1	-12.6	-10.8	-6.1	-5.4

1) As calculated in the National Accounts
2) Incl. capital taxes
3) Incl. capital transfers (excl. capital taxes) and consumption of fixed capital
4) Gross fixed capital formation and capital transfers
5) Net lending excluding gross interest expenses

2.3 Local government

The local government financial position is expected to improve considerably in 2020 relative to the record-low level in 2019. This is due to the subsidies paid by the central government to ensure basic services and sustain activity of municipalities. At the same time, the tax revenues of municipalities have grown faster than assumed because earnings have increased more than expected and tax revenues have risen as a result of the adjustment to central government disbursements. Although the local government finances are expected to reach an approximate equilibrium in 2020, the one-off subsidies to deal with the COVID-19 crisis will not solve the long-term imbalance between revenue and expenditure in local government finances, which is due to the pressures to increase social welfare and healthcare expenditure due to the ageing population and the decrease of the working-age population.

The economic projection of local government finances for 2021-2024 is a pressure projection that, in addition to general economic and population trends, only takes into account the measures impacting local government finances that are already included in the Budget proposals and the General Government Fiscal Plan. The projection does not include municipalities' and joint municipal authorities' own measures for the period 2022-2025. They will only be considered after the budgets have been completed. Municipal tax rates have been kept at 2021 levels. The pressure calculation does not take into account the government proposal for the social and healthcare reform and reorganisation of rescue services, which will shift responsibility for organising these services from municipalities to wellbeing services regions.

In 2021, the local government financial position will deteriorate showing a deficit of approx. EUR 1.4 billion despite the recovery of the economy and the support measures undertaken by the central government. This is due to the modest increase in local government revenues, which will be further retarded by the decrease in the central government transfers and the stagnation of municipal tax revenues at the 2020 level. [1] Consumption expenditure will, however, accelerate as the changes in responsibilities foreseen in programme of the Marin Government and pay increases in the municipal sector contribute to the rate of increase in expenditure. Additionally, the cost of protective equipment and COVID-19 testing is expected increase.[2] In 2021, municipalities will inherit a service and healthcare backlog from 2020 because treatments have been postponed due to the heavy restrictions.

Local government investments are assumed to remain at a high level throughout the forecast period although hospital construction is expected to peak in 2021. The sustained growth in investments is expected to level off in 2022 with the contraction of hospital construction. The investment pressures will, however, remain substantial because of the age of the building stock, infrastructure investment needs and migration. The bleak outlook for investment environment

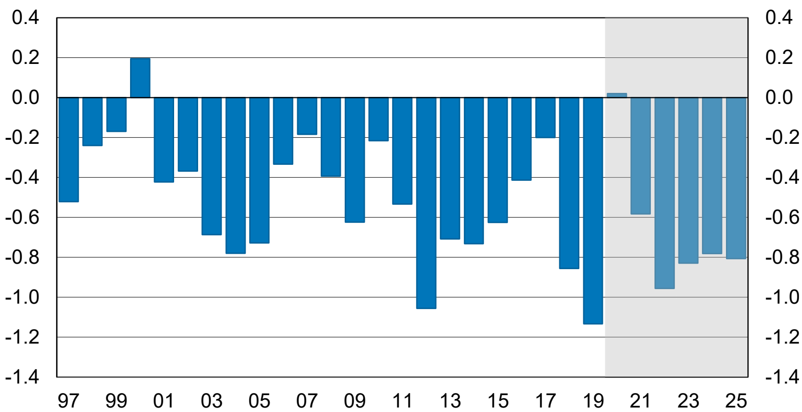
1 The average municipal tax rate will increase by 0.06 percentage points to 20.02%, which will raise tax revenues by about EUR 60 million.

2 The estimate involves a degree of uncertainty, but the Government is committed to fully compensate municipalities for the direct cost of the pandemic (such as the cost of testing, tracking and care). A total of EUR 1.66 billion has been set aside for this purpose. Full compensation will be forthcoming as mandated by the pandemic situation and the implementation of the hybrid strategy. The money allocated for testing cannot be used for other purposes.

may, however, lead to postponement or cancellation of the final investment decisions, as more emphasis must be given to the prioritisation of investments.

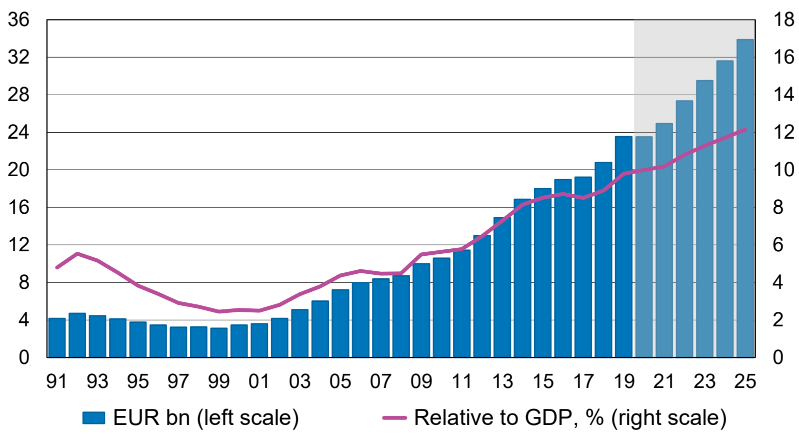
Although the growth of local government expenditure will slow down considerably in 2022 as the COVID-19 crisis eases, the financial position will deteriorate substantially as the temporary support measures are coming to an end. The structural imbalance between revenue and expenditure will increase the local government debt ratio. Because of the budget deficits, local government debt-to-GDP ratio will continue to grow and will reach 12.1% in 2025.

Local government financial balance
relative to GDP, %



Sources: Statistics Finland, MoF VM34098

Local government debt



Sources: Statistics Finland, MoF VM34098

Table 17. Local government[1]

	2018	2019	2020**	2021**	2022**	2023**
	EUR billion					
Taxes and social security contributions	22.5	23.2	24.3	25.0	25.2	25.8
of which municipal tax	18.8	19.4	20.4	20.4	21.0	21.7
corporate tax	1.9	1.9	1.9	2.6	2.1	2.0
real estate tax	1.8	1.9	1.9	2.0	2.0	2.0
Other revenue[2]	19.4	19.8	23.7	24.1	22.8	23.2
of which interest receipts	0.3	0.3	0.3	0.3	0.3	0.3
transfers from central government	14.2	14.4	17.9	18.1	16.7	17.0
Total revenue	**41.8**	**43.0**	**48.0**	**49.1**	**47.9**	**49.0**
Consumption expenditure	35.7	36.9	38.6	40.9	41.0	41.9
of which compensation of employees	21.4	21.8	22.3	23.2	23.7	24.0
Income transfers	2.6	2.8	2.9	2.9	3.0	3.0
of which social security benefits and allowances	0.7	0.8	0.8	0.8	0.8	0.8
subsidies and other transfers	1.8	1.9	2.0	2.0	2.0	2.1
interest expenses	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure[3]	5.5	6.0	6.5	6.7	6.4	6.2
Total expenditure	**43.8**	**45.7**	**48.0**	**50.5**	**50.4**	**51.2**
Net lending (+) / net borrowing (-)	**-2.0**	**-2.7**	**0.0**	**-1.4**	**-2.4**	**-2.2**
Primary balance[4]	-1.9	-2.6	0.1	-1.3	-2.3	-2.1

1) As calculated in National Accounts
2) Incl. capital transfers and consumption of fixed capital
3) Gross capital formation and capital transfers
4) Net lending excluding gross interest expenses

2.4 Social security funds

In 2019, the financial position of employment pension institutions showed a surplus of 1.1% relative to GDP. In 2020, the surplus will be dramatically reduced due to the fall in employment pension contributions. Moreover, private employers' employment pension contributions have been temporarily lowered up to the end of 2020. Its impact will be slightly over EUR 1 billion. In contrast, the private employers' contributions will be increased during 2022–2025, with the result that the sector's financial position will be strengthened to 0.5% relative to GDP. The employment pension assets decreased in the first quarter of 2020 but had almost fully recovered by the end of the third quarter. As a result of the recession and the overall fall in interest rates, dividend and interest income earned by the sector will decrease.

The financial position of other social security funds showed a surplus of 0.3% in 2019. Unemployment benefits increased sharply in 2020, mainly due to the record-fast rise in the number of temporary lay-offs. Although the number of those laid off fell quickly towards the end of the year, it will still remain high in 2021. Additionally, benefit expenditure was further increased by temporary improvements to the terms and coverage of unemployment security. Other benefits have also been temporarily increased. The reduction in unemployment insurance contributions effective as of the beginning of 2020 will decrease the sector's revenues. Another reason for the fall in the insurance contributions is the reduced wagebill. In 2020, the financial position of other social security funds will turn into a deficit despite the fact that the central government will contribute towards the cost of unemployment security exceptionally, for example by co-funding earning-related unemployment benefits paid for lay-off periods. Unemployment insurance contributions will be increased at the start of 2021. For the next few years, the sector will show a deficit, which will turn into a narrow surplus once unemployment decreases.

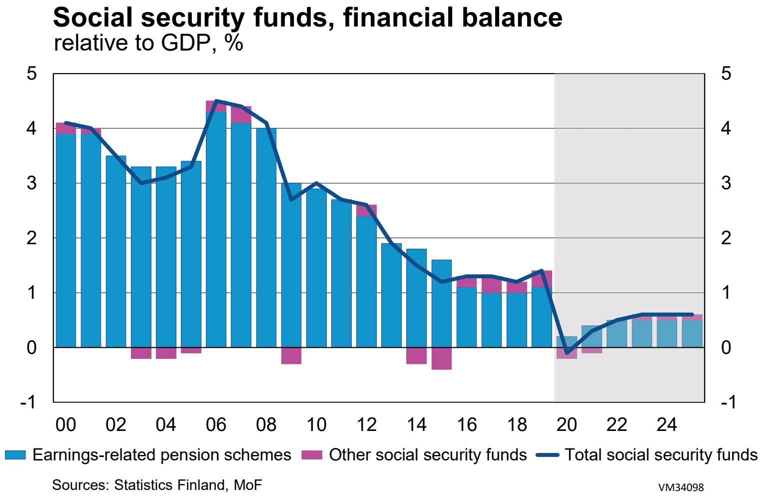


Table 18. Finances of social security funds[1]

	2018	2019	2020**	2021**	2022**	2023**
	EUR billion					
Investment income	4.1	4.3	3.7	3.6	3.9	4.3
Social security contributions	27.9	28.5	27.5	29.9	30.7	31.6
of which contibutions paid by employers	17.6	17.9	16.7	18.5	19.2	19.8
contributions paid by insured	10.3	10.6	10.8	11.4	11.5	11.8
Transfer from general government	15.5	15.7	17.4	16.7	16.5	16.5
Other revenue	0.3	0.4	0.4	0.4	0.4	0.4
Total revenue	**47.8**	**48.9**	**49.0**	**50.6**	**51.5**	**52.8**
Consumption expenditure	3.7	3.8	3.9	4.2	4.2	4.2
Social security benefits and allowances	37.9	38.6	41.5	41.9	42.4	43.3
Other outlays	3.3	3.2	3.8	3.7	3.6	3.7
Total expenditure	**44.9**	**45.6**	**49.2**	**49.8**	**50.3**	**51.2**
Net lending (+) / net borrowing (-)	**2.9**	**3.3**	**-0.2**	**0.8**	**1.2**	**1.6**
Earnings-related pension schemes	2.3	2.7	0.4	1.1	1.3	1.4
Other social security funds	0.6	0.6	-0.5	-0.3	-0.1	0.2
Primary balance[2]	2.9	3.4	-0.1	0.8	1.3	1.7

1) As calculated in National Accounts
2) Net lending excluding gross interest expenses

MINISTRY
OF FINANCE

MINISTRY OF FINANCE
Snellmaninkatu 1 A
PO BOX 28, 00023 GOVERNMENT
Tel. +358 295 160 01
financeministry.fi

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